DISCLOSURE OF IRS INFORMATION TO ASSIST WITH THE ENFORCEMENT OF CRIMINAL LAW

HEARING

BEFORE THE

SUBCOMMITTEE ON OVERSIGHT OF THE
INTERNAL REVENUE SERVICE

OF THE

COMMITTEE ON FINANCE
UNITED STATES SENATE

NINETY-SEVENTH CONGRESS

FIRST SESSION

ON

S. 732

NOVEMBER 9, 1981

Printed for the use of the Committee on Finance

U.S. GOVERNMENT PRINTING OFFICE
88-137 O WASHINGTON : 1982 HG 97-58

S361-24

COMMITTEE ON FINANCE

ROBERT J. DOLE, Kansas, *Chairman*

BOB PACKWOOD, Oregon
WILLIAM V. ROTH, Jr., Delaware
JOHN C. DANFORTH, Missouri
JOHN H. CHAFEE, Rhode Island
JOHN HEINZ, Pennsylvania
MALCOLM WALLOP, Wyoming
DAVID DURENBERGER, Minnesota
WILLIAM L. ARMSTRONG, Colorado
STEVEN D. SYMMS, Idaho
CHARLES E. GRASSLEY, Iowa

RUSSELL B. LONG, Louisiana
HARRY F. BYRD, Jr., Virginia
LLOYD BENTSEN, Texas
SPARK M. MATSUNAGA, Hawaii
DANIEL PATRICK MOYNIHAN, New York
MAX BAUCUS, Montana
DAVID L. BOREN, Oklahoma
BILL BRADLEY, New Jersey
GEORGE J. MITCHELL, Maine

Robert E. Lighthizer, *Chief Counsel*
Michael Stern, *Minority Staff Director*

Subcommittee on Oversight of the Internal Revenue Service

CHARLES F. GRASSLEY, Iowa, *Chairman*

ROBERT J. DOLE, Kansas
MAX BAUCUS, Montana

CONTENTS

ADMINISTRATION WITNESSES

Page

Egger, Hon. Roscoe, Jr., Commissioner of Internal Revenue Service accompanied by David G. Glickman, Deputy Assistant Secretary for Tax Policy, Treasury Department 63

Schmultz, Edward C., Deputy Attorney General, Department of Justice 76

Anderson, William J., Director of General Government Division, General Accounting Office accompanied by Andrea Cole, attorney and John Gunner, audit manager 148

Walker, John M., Jr., Assistant Secretary for Enforcement and Operations, Department of the Treasury, accompanied by Jordan Luke, Assistant General Counsel 180

PUBLIC WITNESSES

Alexander, Donald, former Commissioner of the Internal Revenue Service now with Morgan, Lewis & Bockius 182

American Civil Liberties Union, John H. F. Shattuck, legislative director 196

Chamber of Commerce of the United States, Edwin S. Cohen, chairman, taxation committee 187

Chiles, Hon. Lawton, a U.S. Senator from Florida 34

Cohen, Edwin S., chairman, taxation committee, Chamber of Commerce of the United States 187

Kurtz, Jerome, former Commissioner of the Internal Revenue Service now with Paul, Weiss, Rifkind, Wharton & Garrison 183

Morgan, Lewis & Bockius, Donald Alexander, former Commissioner of IRS 182

Nunn, Hon. Sam, a U.S. Senator from Georgia 102

Paul, Weiss, Rifkind, Wharton & Garrison, Jerome Kurtz, former Commissioner of IRS 183

Shattuck, John H. F., legislative director, American Civil Liberties Union 196

ADDITIONAL INFORMATION

Committee press release 2

Text of bill S. 732 18

Joint Committee on Taxation description of S. 732 3

Prepared statement of Senator Lawton Chiles 39

Report by GAO entitled "Gains Made in Controlling Illegal Drugs, Yet the Drug Trade Flourishes" 48

Prepared statement of Senator Max Baucus 61

Prepared statement of Roscoe L. Egger, Jr 68

Prepared statement of Edward C. Schmultz 81

Letter from Edward C. Schmultz to Senator Grassley 95

Prepared statement of Senator Sam Nunn 109

Prepared statement of William J. Anderson 150

Prepared statement of Edwin S. Cohen 189

Prepared statement of John H. F. Shattuck 199

COMMUNICATIONS

Weicker, Hon. Lowell, Jr., a U.S. Senator from Connecticut 221

DISCLOSURE OF IRS INFORMATION TO ASSIST WITH THE ENFORCEMENT OF CRIMINAL LAW

MONDAY, NOVEMBER 9, 1981

U.S. SENATE, SUBCOMMITTEE ON OVERSIGHT OF THE INTERNAL REVENUE SERVICE OF THE COMMITTEE ON FINANCE,

Washington, D.C.

The subcommittee met, pursuant to call, at 2:05 p.m. in room 2221, Dirksen Senate Office Building, Hon. Charles Grassley (chairman of the subcommittee) presiding.

Present: Senators Grassley and Baucus.

[The committee press release announcing this hearing, the bill S. 732, and the description of this bill by the Joint Committee on Taxation follow:]

Press Release No. 81-173

PRESS RELEASE

FOR IMMEDIATE RELEASE
October 28, 1981

COMMITTEE ON FINANCE
UNITED STATES SENATE
Subcommittee on Oversight of
the Internal Revenue Service
2227 Dirksen Senate Office Bldg.

FINANCE SUBCOMMITTEE ON OVERSIGHT OF THE INTERNAL REVENUE SERVICE SETS HEARING ON DISCLOSURE OF INTERNAL REVENUE SERVICE INFORMATION TO ASSIST WITH THE ENFORCEMENT OF FEDERAL AND STATE CRIMINAL LAWS

Senator Charles Grassley, Chairman of the Subcommittee on Oversight of the Internal Revenue Service of the Senate Committee on Finance, announced today that the Subcommittee will hold a hearing on Monday, November 9, 1981, on the disclosure of Internal Revenue Service information to assist with the enforcement of Federal and State criminal laws.

The hearing will begin at 2:00 p.m. in Room 2221 of the Dirksen Senate Office Building.

Senator Grassley stated that the Subcommittee would welcome testimony on the general topic of the disclosure of Internal Revenue Service information to Federal and State authorities to assist with the enforcement of nontax criminal laws, as well as specific testimony relating to S. 732.

S. 732, introduced by Senator Nunn, would generally allow the disclosure of Internal Revenue Service information to assist with the enforcement of nontax criminal laws upon: (1) an ex parte order of a Federal district court judge or magistrate if information provided by the taxpayer is being disclosed; and (2) a written request from the head of a Federal agency or the Attorney General if third party information which the Secretary has collected or received is being disclosed.

In addition, S. 732 also would: (1) permit an attorney for the Government to redisclose taxpayer return information to other Federal Government personnel or witnesses; (2) impose an afffirmative duty upon the Secretary to disclose information concerning possible criminal activities under certain circumstances; (3) permit redisclosure of information to State authorities; (4) permit the disclosure of information to foreign governments; and (5) create an affirmative defense to the unauthorized disclosure of certain information.

DESCRIPTION OF S. 732
AND PRESENT LAW
RELATING TO
DISCLOSURE OF TAX RETURNS AND RETURN INFORMATION FOR PURPOSES OF NONTAX CRIMINAL LAW ENFORCEMENT

PREPARED FOR THE USE OF THE

COMMITTEE ON FINANCE

BY THE STAFF OF THE

JOINT COMMITTEE ON TAXATION

INTRODUCTION

The Subcommittee on Oversight of the Internal Revenue Service of the Senate Finance Committee has scheduled a hearing on November 9, 1981, on the subject of the disclosure of tax information to assist with the enforcement of Federal and State criminal laws. This pamphlet provides a description of present law relating to the disclosure of tax returns and return information for purposes of administering nontax Federal criminal laws, and a bill (S. 732, sponsored by Senators Nunn, Chiles, DeConcini, Cohen, Bentsen, Domenici, Long, Roth, Rudman, Jackson, Schmitt, Boren, Pryor, Johnston, Holland, Exon, Stennis, Danforth, Mattingly, and Zorinskv) which would expand disclosure for that purpose.

The first part of the pamphlet is a summary of the bill. The second part contains certain background information, including a brief description of recent Congressional interest in the disclosure law. The third part of the pamphlet contains an explanation of present law. The fourth part contains a brief discussion of the issues relating to the disclosure of tax information for purposes of nontax criminal law enforcement. The fifth part provides an explanation of the provisions of the bill.

I. SUMMARY

S. 732—Senators Nunn, Chiles, et al.

Disclosure of Tax Information for Purposes of Nontax Federal and State Criminal Law Enforcement

Under present law, Federal agencies may, in certain circumstances, receive tax returns, taxpayer return information, and return information [1] from the Internal Revenue Service for their use in nontax criminal investigations. Returns and taxpayer return information are available only pursuant to an ex parte order granted by a Federal district court judge. Return information, other than taxpayer return information, may be received by written request. The IRS may refuse to disclose tax returns, taxpayer return information, or return information if it determines that disclosure would identify a confidential informant or seriously impair a civil or criminal tax investigation. Present law also permits, but does not require, the IRS to disclose return information, other than taxpayer return information, which may constitute evidence of a violation of Federal criminal laws, to the extent necessary to apprise the head of the appropriate Federal agency charged with enforcing such laws.

Under present law, the unauthorized disclosure of tax returns or return information is a felony punishable upon conviction by a fine of not more than $5,000 or imprisonment of not more than 5 years, or both.

Under present law, a taxpayer may bring a civil action for damages against a person who knowingly or negligently discloses returns or return information in violation of the disclosure provisions.

The bill would modify the standards for obtaining an ex parte court order for the disclosure of returns and books and records of individuals. In addition, the books and records of any business or other entity consisting of more than two owners would be available upon written request. Furthermore, tax information that has been disclosed by the Internal Revenue Service to the Department of Justice could be redisclosed to other Federal law enforcement personnel and witnesses and could, pursuant to court order, be redisclosed to certain State law enforcement officials.

The Internal Revenue Service would be required to disclose any nonreturn information (generally books and records of a business or other entity consisting of more than two owners) that may constitute evidence of a violation of Federal criminal law to the appropriate Federal agency. Moreover, in certain emergency situations, the Internal Revenue Service could disclose returns on its own initiative.

In certain circumstances, the bill would permit disclosure of tax information to foreign law enforcement officials.

Under the bill, a Federal employee would not be criminally liable for a wrongful disclosure that results from a good faith, but erroneous, interpretation of the law while the employee was acting within the scope of his employment. Moreover, any civil action for wrongful disclosure would be brought against the appropriate Federal agency, rather than a Federal employee.

---

[1] These terms are defined in Part III of this pamphlet ("Present Law").

II. BACKGROUND

Prior Law

Under the law prior to the Tax Reform Act of 1976, income tax returns were described as "public records." However, tax returns generally were open to inspection only under regulations approved by the President, or under Presidential order. Pursuant to those regulations, a U.S. Attorney or Justice Department attorney could obtain tax information in any case "where necessary in the performance of his official duties," by written application to the IRS. Tax information obtained by the Justice Department could be used in proceedings conducted by or before any department or establishment of the Federal Government or in which the United States was a party.

In connection with the enforcement of nontax criminal and civil statutes, tax information was made available to each executive department and other establishments of the Federal Government in connection with matters officially before them, on the written request of the head of the agency. Tax information obtained in this manner could be used as evidence in any proceeding before any "department or establishment" of the United States or in any proceedings in which the United States was a party.

Tax Reform Act of 1976

In enacting the disclosure provisions contained in the Tax Reform Act of 1976, the Congress was concerned with the fact that the Justice Department and other Federal agencies were able to obtain tax returns and tax information for nontax purposes almost at their sole discretion. It was the intent of Congress that private papers which an American citizen is compelled by the tax laws to disclose to the IRS should be entitled to essentially the same degree of privacy as those private papers maintained in his home. Thus, the Congress decided that the Justice Department and any other Federal agency responsible for the enforcement of a nontax criminal law should be required to obtain court approval for the inspection of a taxpayer's return or return information submitted by, or on behalf of, the taxpayer. Furthermore, with respect to nontax civil matters, the Congress decided that returns and return information generally could not be disclosed to the Justice Department.

Other Congressional Action

On December 7, 11, 12, 13, and 14, 1979, the Permanent Subcommittee on Investigations of the Senate Committee on Governmental Affairs held hearings on illegal narcotics profits. Among other things, these hearings examined the extent of cooperation between the IRS and other Federal law enforcement agencies in the area of narcotics enforcement, and the effects of the disclosure provisions on that cooperation.

On December 11, 1979, the Senate agreed, by a vote of 65 to 8, to table an amendment to the Crude Oil Windfall Profit Tax Act, offered by Senator DeConcini, which would have authorized disclosure of any tax information in the possession of the IRS upon the written request of the head of a Federal law enforcement agency. In addition, the amendment would have placed an affirmative duty upon the IRS to notify the appropriate law enforcement agency whenever there was reasonable cause to believe that information within its control could indicate the violation of any Federal criminal law constituting a felony.

On April 22, 1980, the Subcommittee on Treasury, Postal Service, and General Government of the Senate Appropriations Committee held hearings on proposed budget estimates for fiscal year 1981 for the IRS. Among other things, these hearings focused on the disclosure of information by the IRS to Federal law enforcement agencies, and recent efforts to improve coordination between the IRS and Justice Department in the investigation and prosecution of nontax Federal criminal cases.

On June 20, 1980, the Subcommittee on Oversight of the Internal Revenue Service of the Senate Finance Committee held a hearing on several bills relating to the disclosure of tax returns and return information for purposes not relating to tax administration. Several of the bills that were the subject of that hearing, although different than S. 732, were similar in thrust.[1]

The provisions of S. 732 were contained in the Senate version of the Economic Recovery Tax Act of 1981.[2] The provisions were not agreed to in conference. However, the conferees indicated their intention that the matter should be examined thoroughly in Congressional hearings in the near future and that appropriate legislative action should be taken.[3]

---

[1] For a description of the bills that were the subject of that hearing, see the pamphlet prepared by the staff of the Joint Committee on Taxation (JCS-30-80, June 18, 1980).

[2] Floor amendment by Senator Nunn, adopted by voice vote; motion to table defeated 28 to 66. (See, 127 *Cong. Rec.* S. 8513 (daily ed. July 27, 1981)).

[3] See, H.R. Rep. No. 97-215, 97th Cong. 1st Sess. 263 (1981).

III. PRESENT LAW

Disclosure of Returns and Return Information for Purposes of Nontax Criminal Law Enforcement

Section 6103 of the Internal Revenue Code governs the disclosure of returns and return information. Under present law, returns and return information are to be confidential and not subject to disclosure unless specifically provided in section 6103 or other sections of the Code. The level of protection that currently is afforded to tax information depends upon whether the particular information is a return, return information, or taxpayer return information.

Definitions

Return.—The term "return" is defined as any tax or information return, declaration of estimated tax, or claim for refund which is required (or permitted) to be filed on behalf of, or with respect to, any person. A return also includes any amendment, supplemental schedule, or attachment filed with the tax return, information return, etc.

Return information.—"Return information" includes the following data pertaining to a taxpayer: his identity, the nature, source, or amount of his income, payments, receipts, deductions, exemptions, credits, assets, liabilities, net worth, tax liability, tax withheld, deficiencies, overassessments, and tax payments. Also included in the definition of return information is any particular of any data, received by, recorded by, prepared by, furnished to, or collected by the IRS with respect to a return filed by the taxpayer or with respect to the determination of the existence, or possible existence, of liability for any tax, penalty, interest, fine, forfeiture, or other imposition, or offense provided for under the Code. A summary of data contained in a return and information concerning whether a taxpayer's return was, is being, or will be examined or subject to other investigation or processing also is return information. However, data in a form which cannot be associated with, or otherwise identify, directly or indirectly, a particular taxpayer is not return information. (Notwithstanding this sentence, or any other provision of law, nothing is to be construed to require the disclosure of standards used or to be used for the selection of returns for examination, or data used or to be used for determining such standards, if the Secretary determines that such disclosure would seriously impair assessment, collection, or enforcement under the internal revenue laws.)[1]

Taxpayer return information.—"Taxpayer return information" is return information which is filed with, or furnished to, the IRS by, or on behalf of, the taxpayer to whom the return information relates.

---

[1] This latter provision was added by section 701 of the Economic Recovery Tax Act of 1981 (P.L. 97-34).

This includes, for example, data supplied by a taxpayer's representative to the IRS in connection with an audit and data received by the IRS from a taxpayer's representative pursuant to an administrative summons issued in connection with an IRS civil or criminal investigation of the taxpayer.

Disclosures

The IRS is authorized to disclose returns or taxpayer return information to other Federal agencies, for purposes of nontax criminal investigations,[2] only upon the grant of an ex parte order by a Federal district court judge (Code sec. 6103(i)(1)). An ex parte order may be granted upon the determination of the judge that: (1) there is reasonable cause to believe, based upon information believed to be reliable, that a specific criminal act has been committed; (2) there is reason to believe that the return or return information is probative evidence of a matter in issue related to the commission of the criminal act; and (3) the information sought to be disclosed cannot reasonably be obtained from any other source, unless the information is the most probative evidence of a matter in issue relating to the commission of the criminal act.

In the case of the Justice Department, only the Attorney General, the Deputy Attorney General, or an Assistant Attorney General may authorize an application for an order. In the case of other Federal agencies, the head of the agency is required to authorize the application.

Return information, other than taxpayer return information, may be disclosed to the head of a Federal agency or to the Attorney General, Deputy Attorney General, or an Assistant Attorney General upon written request setting forth: (1) the name and address of the taxpayer with respect to whom the information relates; (2) the taxable periods involved; (3) the statutory authority under which the proceeding or investigation (to which the information is relative) is being conducted; and (4) the specific reasons why the disclosure is or may be material to the proceeding or investigation (Code sec. 6103(i)(2)). In addition, the Secretary of the Treasury is authorized to disclose return information, other than taxpayer return information, which may constitute evidence of a violation of Federal criminal laws to the extent necessary to apprise the head of the appropriate Federal agency charged with the responsibility of enforcing those laws (Code sec. 6103(i)(3)).

In the case of any requested disclosure, the Secretary has the authority to withhold the requested return or return information if it is determined that disclosure would identify a confidential informant or seriously impair a civil or criminal tax investigation.

In general, returns or return information disclosed by the IRS to a Federal agency may be entered into evidence in any administrative or judicial proceeding pertaining to enforcement of a specifically designated Federal criminal statute (not involving tax administration) to which the United States or the agency is a party. However, a return or return information disclosed pursuant to the court order procedure may be entered into evidence only if the court finds that it is probative of a matter in issue relevant in establishing the commission of a crime or the guilt of a party. The Secretary has the authority to withhold a return or return information from a criminal trial or hearing upon his determination that the disclosure would identify a confidential informant or seriously impair a civil or criminal tax investigation. The admission into evidence of any return or return information contrary to these disclosure provisions does not, as such, constitute reversible error upon appeal of a judgment (Code sec. 6103(i)(4)).

---

[2] That is, for use by the agency in preparation for any administrative or judicial proceeding (or investigation which may result in such a proceeding) pertaining to the enforcement of a specifically designated Federal criminal statute (not involving tax administration) to which the United States or such agency is or may be a party.

A return or return information may be disclosed to a competent authority of a foreign government that has an income tax or gift and estate tax convention or other convention relating to the exchange of tax information with the United States. This information may be disclosed only to the extent provided in, and subject to the terms and conditions of, such convention.

Penalties for Unauthorized Disclosure of Tax Information

Under present law, an unauthorized, willful disclosure of a tax return or return information constitutes a felony which, upon conviction, is punishable by a fine of up to $5,000 or imprisonment of up to 5 years, or both (Code sec. 7213(a)). These penalties may apply to present and former Federal and State officers and employees, to one-percent shareholders, and to officers and employees of contractors for processing, storing, and reproducing returns and return information.

Civil Damages for Unauthorized Disclosure of Tax Information

Under present law, any person who willfully or negligently discloses tax returns or return information in violation of the law may be liable for actual damages sustained by the taxpayer (Code sec. 7217). Punitive damages are authorized in situations where the unlawful disclosure is willful or is the result of gross negligence. In no event are these damages to be less than $1,000 for each unauthorized disclosure. However, no liability for this penalty shall arise in the event of an unauthorized disclosure which results from a good faith, but erroneous, interpretation of the disclosure laws.

IV. ISSUES

In General

As indicated in the Background section of this pamphlet, there has been much recent Congressional interest in the laws relating to the disclosure of tax returns and return information, and the impact these laws have had on Federal criminal law enforcement. Many individuals, while acknowledging that the disclosure laws prior to 1977 were too loose and permitted far too many disclosures, believe that the Tax Reform Act of 1976 was too restrictive and has had a deleterious effect on legitimate law enforcement activities. Others have felt that it is the primary function of the IRS to collect taxes, rather than participate in nontax criminal law enforcement, and that the 1976 Act struck a proper balance between these activities. Some have raised questions with respect to whether tax returns and return information should be used for any purposes other than tax administration.

To some individuals, it is not present law which has hampered cooperation between the IRS and other Federal agencies with respect to criminal law enforcement, but, rather, the way in which they believe present law has been interpreted and administered by the IRS. These individuals, while preferring that present law be maintained, would favor sending a signal from Congress to the IRS mandating that the IRS comply expeditiously with the present law disclosure provisions and that it not attempt to circumvent the law by establishing artificial barriers to the dissemination of tax information in legitimate circumstances.

As the Congress noted in the consideration of the 1976 Act, the IRS probably has more information about more people than any other government agency in this country. Consequently, almost every other agency that had a need for information about U.S. citizens generally sought it from the IRS. Accordingly, in considering any legislation dealing with the disclosure of tax returns and return information, the committee probably would want to balance the needs of law enforcement agencies for IRS assistance and information with the citizen's right to privacy and the related impact of the disclosure upon the continuation of compliance with the Nation's tax assessment system.

Specific Disclosure Issues

In addition to these fundamental policy issues, S. 732 raises a number of other technical and substantive issues that the committee may want to consider. These issues include: (1) the types of tax information that should be protected by court order on the one hand and tax information that should be available through written request on the other hand; (2) whether the standards for obtaining a court order for the disclosure of tax information should be modified; (3) whether it should be easier to obtain books and records of business and other entities comprised of more than two individuals than it is to obtain books and records of smaller businesses or of individuals; (4) whether tax information that has been disclosed to the Justice Department should be permitted to be redisclosed to other Federal law enforcement agencies; (5) whether tax information that has been disclosed to the Justice Department or to other Federal agencies should be permitted to be redisclosed to certain State law enforcement officials for purposes of enforcing State felony statutes; (6) the extent to which tax information should be disclosed to foreign governments for use by a foreign country in a foreign nontax criminal investigation or proceeding; (7) the circumstances under which the IRS should be permitted to refuse to disclose tax information; (8) the circumstances under which the IRS should have an affirmative duty, on its own initiative, to disclose tax information; (9) whether Federal district court magistrates, as well as judges, should be permitted to grant court orders for the disclosure of tax information; and (10) the personnel level at which an application for a disclosure order should be permitted.

V. DESCRIPTION OF S. 732

Senators Nunn, Chiles, et al.

Explanation of Provisions

Classification of tax information

For purposes of disclosure, the bill would divide all tax information into two major categories: (1) return information and (2) nonreturn information.[1] The level of protection afforded to tax information would depend upon which category the particular information is in.

Return information.—Return information would be a tax return, information return, declaration of estimated tax, or claim for refund, as well as any amendment or supplement thereto, that is filed with the Secretary by, on behalf of, or with respect to, any person. (Amendments or supplements would include supporting schedules, attachments, or lists that are supplemental to, or part of, returns or information taken from returns.) In addition to returns, etc., return information also would be any information provided to the Secretary by, or on behalf of, an individual taxpayer to whom the information relates. An individual taxpayer would be any natural person or a corporation, partnership, association, union, or other entity consisting of no more than two owners, shareholders, partners, or members.

Nonreturn information.—Nonreturn information generally would be any information that is not included within the definition of return information. Specifically, this would be any information (other than a return) provided to the Secretary by, or on behalf of, someone other than the taxpayer to whom the information relates (for example, information with respect to an individual that is submitted by a third-party). In addition, this would include any information (other than returns), received by the Secretary, that relates to any corporation, partnership, association, union, or other entity consisting of more than two owners, shareholders, partners, or members. Nonreturn information also includes written determinations from the Internal Revenue Service, or any background file documents relating to written determinations, that are not open to public inspection. However, nonreturn information would not include data in a form that cannot be associated with, or otherwise identify, directly or indirectly, a particular taxpayer.[2]

---

[1] As noted in Part III (Present Law), above, present law divides tax information into three categories: (1) returns, (2) return information, and (3) taxpayer return information.

[2] The present law definition of return information was amended by section 701 of the Economic Recovery Tax Act of 1981 (P.L. 97–34). The amendment provides that no provision of law is to be construed to require disclosure of standards used or to be used for the selection of returns for examination, or data used or to be used for determining such standards, if the Secretary determines that such disclosure would seriously impair assessment, collection, or enforcement under the internal revenue laws.

Disclosure of return information

The Internal Revenue Service would be required to disclose return information pursuant to the order of a Federal district court judge or magistrate. Upon the issuance of an ex parte order, return information would be open to inspection by, or disclosure to, officers and employees of the Department of Justice who are personally and directly engaged in, and solely for their use in preparation for, any administrative, judicial, or grand jury proceeding (or investigation that may result in such a proceeding) pertaining to the enforcement of a specifically designated Federal criminal statute (not involving tax administration) to which the United States or Department of Justice is, or may be, a party. The order may provide for continuous disclosure.

Only certain specified officers and employees of the Department of Justice would be permitted to authorize an application to be filed with a Federal district court judge or magistrate for the disclosure of return information. The officers and employees specified are the Attorney General, the Deputy Attorney General, an Assistant Attorney General, a United States attorney, or the attorney in charge of a criminal division organized crime strike force.

A Federal district court judge or magistrate could grant an order requiring the disclosure of return information only if, on the basis of facts submitted by the applicant, certain findings were made. These findings would be that (1) there is reasonable cause to believe, based upon information believed to be reliable, that a specific criminal act has been committed or is being committed; the information is being sought exclusively for use in a Federal criminal investigation or proceeding concerning such criminal act; and (3) there is reasonable cause to believe that the information may be relevant to a matter relating to the commission of such criminal act. The Secretary would be able to decline to disclose any return information if he determines, and certifies to the court, that the disclosure would identify a confidential informant or seriously impair a civil or criminal tax investigation. If this is not a problem, then the Secretary would be required to disclose return information, with respect to which an order has been granted, as soon as practicable after receipt of an order.

The bill would permit attorneys to whom disclosure has been made to disclose the information further to such other Federal Government personnel or witnesses as is deemed necessary for assistance during a criminal investigation or in preparation for the administrative, judicial, or grand jury proceeding that formed the basis for the order.

Disclosure of nonreturn information

The bill would permit nonreturn information to be disclosed upon written request from the head of a Federal agency, the Inspector General of a Federal agency, or the Attorney General or his designee. This written request would be required to set forth (1) the name and address of the taxpayer with respect to whom the requested nonreturn information relates; (2) the taxable period or periods to which the nonreturn information relates; (3) the statutory authority under which the proceeding or investigation is being conducted; and

(4) allegations of criminal conduct giving rise to the proceeding or investigation.

The Secretary would be required to disclose nonreturn information as soon as practicable unless it is determined that disclosure would identify a confidential informant or seriously impair a civil or criminal tax investigation. The disclosure would be made to the officers and employees of a Federal agency who are personally and directly engaged in, and solely for their use in, or preparation for, any administrative, judicial, or grand jury proceeding (or investigation that may result in such a proceeding) pertaining to the enforcement of a specifically designated Federal criminal statute (not involving tax administration) to which the United States or a Federal agency is or may be a party.

The head of a Federal agency, or the Attorney General or his designee, to whom the disclosure of nonreturn information has been made, could disclose further such information to other Federal Government personnel or witnesses who are deemed necessary for assistance during a criminal investigation or in preparation for the administrative, judicial, or grand jury proceeding that formed the basis for the disclosure request.

The bill would provide that the name, address, and social security number of a taxpayer, whether a taxpayer filed a return for a given year or years, and whether there is or has been a criminal investigation of a taxpayer is nonreturn information for purposes of the provisions governing the information available through written request. Thus, that type of information, as well as information received from a third party and books and records of a business or other entity comprised of more than two persons, would be available upon written request (i.e., without having to apply to a Federal district court judge or magistrate for an *ex parte* order).

Duty of the Secretary to disclose information concerning possible criminal activities

The bill would require the Secretary to disclose in writing, as soon as practicable, any nonreturn information that may constitute evidence of a violation of Federal criminal laws. This disclosure would be initiated by the Secretary. Nonreturn information would be disclosed to the extent necessary to apprise the head of the appropriate Federal agency (or his designee) who is charged with the responsibility for enforcing the law that has been violated. For purposes of this provision, nonreturn information would include the name and address of a taxpayer.

Furthermore, when the Secretary makes a recommendation to the Department of Justice for prosecution for a violation of the Internal Revenue Code, any return or nonreturn information reviewed. developed, or obtained during the tax investigation that may constitute evidence of a violation of Federal criminal laws would be required to be furnished to the Department of Justice, for use in a nontax criminal investigation without securing a court order.

The Secretary could decline to disclose any return or nonreturn information under the foregoing provisions if it is determined that such disclosure would identify a confidential informant or seriously impair a civil or criminal tax investigation.

Finally, the Secretary would be permitted to disclose information in certain emergency circumstances. Under emergency circumstances that involve an imminent danger of physical injury to any person, serious physical damage to property, or flight from prosecution, the Secretary or his designee could disclose any information (including return information) to the extent necessary to apprise the appropriate Federal agency of the emergency. The Secretary or his designee would be required to notify the Department of Justice that a disclosure was made because of emergency circumstances, as soon as practicable after the disclosure. The Department of Justice then would notify the appropriate United States district court or magistrate of the disclosure.

Use of tax information in judicial or administrative proceedings

Any tax information (return and nonreturn information) that is disclosed under the provisions of the bill, except information disclosed in emergency circumstances, could be entered into evidence in accordance with the Federal Rules of Evidence or other applicable law in any administrative, judicial, or grand jury proceeding pertaining to enforcement of a specifically designated Federal criminal statute (not involving tax administration) or in any ancillary civil proceeding to which the United States or any Federal agency is a party. This information could be disclosed pursuant to applicable Federal discovery requirements, to the extent required by a court order. The court, in issuing such order, would be authorized to give due consideration to Congressional policy favoring the confidentiality of return and nonreturn information.

Tax information generally would not be admitted into evidence in any judicial or administrative proceeding if the Secretary determined and notified the Attorney General or his designee, or the head of the Federal agency to whom disclosure has been made, that admission into evidence would identify a confidential informant or seriously impair a civil or criminal tax investigation. However, the court would be able to direct that disclosure be made over the objection of the Secretary.

Assistance of IRS in joint tax and nontax investigations

The bill would provide that no portion of Code section 6103 (the provision governing disclosure of tax information) could be interpreted to preclude or prevent the Internal Revenue Service from assisting the Department of Justice or any other Federal agency in joint tax and nontax investigations of criminal matters that may involve income tax violations. Moreover, no portion of that provision could be interpreted to preclude or prevent the Internal Revenue Service from investigating or gathering relevant information concerning persons engaged in criminal activities that may involve tax violations.

Redisclosure of tax information to State authorities

Under the bill, any official who is authorized to apply for disclosure[3] could apply to a Federal district court judge or magistrate for an ex parte order to disclose any return or nonreturn information in his possession, which is relevant to the violation of a State felony statute, to the appropriate State attorney general or district attorney. An application for redisclosure of tax information to a State attorney general or district attorney would be required to set forth (1) the name and address of the taxpayer and the taxable period or periods to which the information relates; (2) a description of the information sought to be disclosed; and (3) the State felony violation involved.

---

[3] That is, in the case of return information, the Attorney General, the Deputy Attorney General, an Assistant Attorney General, a United States attorney, or the attorney in charge of a criminal division organized crime strike force; and, in the case of nonreturn information, the Attorney General or his designee, and the head of any other Federal agency or Inspector General thereof.

A Federal district court judge or magistrate could grant an order for redisclosure of tax information to a State attorney general or district attorney only if certain findings were made. Specifically, the judge or magistrate would have to determine, on the basis of facts submitted by the applicant for redisclosure, that (1) there is reasonable cause to believe, based upon information believed to be reliable, that a specific State felony violation has occurred or is occurring and (2) there is reasonable cause to believe that the information may be relevant to a matter relating to the commission of the violation.

Disclosure to competent authority under an international convention

The bill would permit the disclosure, in certain circumstances, of return or nonreturn information to a competent authority of a foreign government that has an income tax or gift and estate tax convention, treaty on mutual assistance, or other convention relating to the exchange of tax information with the United States. However, this information could be disclosed only to the extent provided in, and subject to the terms and conditions of, the treaty or convention.

The bill provides that if return or nonreturn information is sought pursuant to the terms of a treaty on mutual assistance in criminal matters for use in an investigation or proceeding that is not related to the tax laws of the requesting foreign country, then disclosure may be made for the use of officials of the requesting country only after the issuance of an ex parte order by a United States district court judge or magistrate. An ex parte order for disclosure would be granted only upon a finding by the judge or magistrate that (1) there is reasonable cause to believe that the information sought may be relevant to a matter relating to the commission of a specific criminal act that has been committed or is being committed against the laws of the foreign country, and (2) that the information is sought exclusively for use in the foreign country's criminal investigation or proceeding concerning that criminal act.

Penalties for unauthorized disclosure of tax information

Under the bill, it would be an affirmative defense to prosecution for the unauthorized disclosure of return or nonreturn information that the disclosure resulted from a good faith, but erroneous, interpretation of Code section 6103 while a Federal employee was acting within the scope of his employment.

Civil damages for unauthorized disclosure of tax information

The bill provides that if an employee of a Federal agency knowingly or negligently discloses return or nonreturn information with respect to a taxpayer in violation of the provisions of Code section 6103, then the taxpayer who has been wronged may bring a civil action for damages exclusively against the agency for whom the employee works. If any person other than an employee of a Federal agency knowingly or negligently discloses return or nonreturn information, then the taxpayer could bring a civil action directly against that person.

Any civil actions commenced under this provision of the bill would be within the jurisdiction of the district courts of the United States.

Effective Date

The provisions of the bill would be effective upon enactment.

Revenue Effect

The provisions of the bill would have no direct revenue effect, but could involve some additional administrative costs to the IRS.

97TH CONGRESS
1ST SESSION

S. 732

To insure the confidentiality of information filed by individual taxpayers with the Internal Revenue Service pursuant to the Internal Revenue Code and, at the same time, to insure the effective enforcement of Federal and State criminal laws and the effective administration of justice.

IN THE SENATE OF THE UNITED STATES

MARCH 17 (legislative day, FEBRUARY 16), 1981

Mr. NUNN (for himself, Mr. CHILES, Mr. DECONCINI, Mr. COHEN, Mr. BENTSEN, Mr. DOMENICI, Mr. LONG, Mr. ROTH, Mr. RUDMAN, and Mr. JACKSON) introduced the following bill; which was read twice and referred to the Committee on Finance

---

A BILL

To insure the confidentiality of information filed by individual taxpayers with the Internal Revenue Service pursuant to the Internal Revenue Code and, at the same time, to insure the effective enforcement of Federal and State criminal laws and the effective administration of justice.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That paragraph (1) of subsection (b), section 6103 of the Internal Revenue Code of 1954 (26 U.S.C. 6103) is amended to read as follows:

"(1) RETURN INFORMATION.—The term 'return information' means—

"(A) any tax or information return, declaration of estimated tax, or claim for refund required by, or provided for, or permitted under the provisions of this title which is filed with the Secretary by, on behalf of, or with respect to any person, and any amendment or supplement thereto, including supporting schedules, attachments, or lists which are supplemental to, or part of, the returns so filed (or information taken therefrom), and

"(B) any information provided to the Secretary by or on behalf of an individual taxpayer to whom such information relates."

SEC. 2. Paragraph (2) of subsection (b), section 6103 of the Internal Revenue Code of 1954 (26 U.S.C. 6103) is amended as follows:

"(2) NONRETURN INFORMATION.—The term 'nonreturn information' means—

"(A) any information, other than return information, which the Secretary collects, prepares, obtains, or receives with respect to a taxpayer or return relating to the determination of the existence, or possible existence of liability (or the amount thereof) of any person under this title for any tax penalty, interest, fine, forfeiture, or other imposition or offense (including whether a return was filed and whether the taxpayer's return was, is being, or will be examined or subject to other investigation or processing), and

"(B) any part of any written determination or any background file document relating to such written determination (as such terms are defined in section 6110(b)) which is not open to public inspection under section 6110,

but such term does not include data in a form which cannot be associated with, or otherwise identify, directly or indirectly, a particular taxpayer."

SEC. 3. Paragraph (3) of subsection (b) of the Internal Revenue Code of 1954 (26 U.S.C. 6103) is amended to read as follows:

"(3) INDIVIDUAL TAXPAYER.—The term 'individual taxpayer' means any natural person or a corporation, partnership, association, union, or other entity consisting of no more than two owners, shareholders, partners, or members."

SEC. 4. Paragraphs (1), (2), (3), and (4) of subsection (i), section 6103 of the Internal Revenue Code of 1954 (26 U.S.C. 6103) are amended to read as follows:

"(1) DISCLOSURE OF RETURN INFORMATION.—

"(A) DISCLOSURE PURSUANT TO ORDER OF JUDGE OR MAGISTRATE.—Return information shall, pursuant to, and upon the grant of, an ex parte order by a Federal district court, judge, or magistrate as provided by this paragraph, be open, but only to the extent necessary as provided in such order, to inspection by or disclosure to officers and employees of the Department of Justice personally and directly engaged in and solely for their use in preparation for any administrative, judicial, or grand jury proceeding (or investigation which may result in such a proceeding) pertaining to the enforcement of a specifically designated Federal criminal statute (not involving tax administration) to which the United States or such agency is or may be a party. The order may provide for continuous disclosure if such disclosure is justified under subparagraph (B)(iii).

"(B) APPLICATION FOR ORDER.—The Attorney General, the Deputy Attorney General, an Assistant Attorney General, a United States attorney, or the attorney in charge of a criminal division organized crime strike force may authorize an application to a Federal district court judge or magistrate for the order referred to in subparagraph (A). Upon such application, such judge or magistrate may grant such order if he determines on the basis of the facts submitted by the applicant that—

"(i) there is reasonable cause to believe, based upon information believed to be reliable, that a specific criminal act has been committed or is being committed;

"(ii) the information is sought exclusively for use in a Federal criminal investigation or proceeding concerning such criminal act; and

"(iii) there is reasonable cause to believe that the information may be relevant to a matter relating to the commission of such criminal act.

However, the Secretary may decline to disclose any return information under this paragraph if he determines and certifies to the court that such disclosure would identify a confidential informant or seriously impair a civil or criminal tax investigation.

"(C) DUTY OF THE SECRETARY.—The Secretary or his designee shall disclose to the appropriate attorney for the Government (referred to in subsection (B) above) such return information ordered disclosed pursuant to paragraph (i)(1)(A) of this subsection as soon as practicable following receipt of an ex parte court order issued pursuant thereto.

"(D) FURTHER DISCLOSURE.—An attorney for the Government (referred to in subsection (B) above) may further disclose any return information, which has been disclosed to him pursuant to an ex parte order, to such other Federal Government personnel or witness as he deems necessary to assist him during the criminal investigation or in preparation for the administrative, judicial, or grand jury proceeding which formed the basis for such order.

"(2) DISCLOSURE OF NONRETURN INFORMATION.—

"(A) Upon written request from the head of a Federal agency, the Inspector General thereof, or in the case of the Department of Justice, the Attorney General or his designee, the Secretary shall disclose nonreturn information as soon as practicable to officers and employees of such agency personally and directly engaged in, and solely for their use in, or preparation for any administrative, judicial, or grand jury proceeding (or investigation which may result in such a proceeding) described in paragraph (1)(A). Such request shall set forth—

"(i) the name and address of the taxpayer with respect to whom such nonreturn information relates;

"(ii) the taxable period or periods to which the nonreturn information relates;

"(iii) the statutory authority under which the proceeding or investigation is being conducted, and

"(iv) allegations of criminal conduct giving rise to the proceeding or investigation.

However, the Secretary may decline to disclose any nonreturn information under this paragraph if he determines that such disclosure would identify a confidential informant or seriously impair a civil or criminal tax investigation.

"(B) The head of an agency, an Inspector General, or the Attorney General or his designee may further disclose such nonreturn information to such Federal Government personnel or witness as he deems necessary to assist him during the criminal investigation or in preparation for the administrative, judicial, or grand jury proceeding which formed the basis for such request.

"(C) For purposes of this paragraph, the name, address, and social security number of the taxpayer, whether a taxpayer filed a return for a given year or years, and whether there is or has been a criminal investigation of a taxpayer shall be treated as nonreturn information.

"(3) SECRETARY'S DUTY TO DISCLOSE INFORMATION CONCERNING POSSIBLE CRIMINAL ACTIVITIES.—

"(A) The Secretary shall disclose as soon as practicable and in writing nonreturn information which may constitute evidence of a violation of Federal criminal laws to the extent necessary to apprise the head of the appropriate Federal agency or his designee charged with the responsibility for enforcing such laws. For purposes of the preceding sentence, the name and address of the taxpayer shall be treated as nonreturn information.

"(B) In addition to the above disclosures, when the Secretary makes a recommendation to the Department of Justice for prosecution for violation of the Internal Revenue Code, any return or nonreturn information reviewed, developed, or obtained during the tax investigation, which information may constitute evidence of a violation of Federal criminal laws, shall be furnished to the Department of Justice.

"(C) However, the Secretary may decline to disclose any information under the above paragraphs if he determines that such disclosure would identify a confidential informant or seriously impair a civil or criminal tax investigation.

"(4) USE IN JUDICIAL OR ADMINISTRATIVE PROCEEDING.—Any information obtained under paragraph (1), (2), or (3) may be entered into evidence in accordance with the Federal Rules of Evidence or other applicable law in any administrative, judicial, or grand jury proceeding pertaining to enforcement of a specifically designated federal criminal statute (not involving tax administration) or any ancillary civil proceeding to which the United States or any agency thereof is a party. Any such information may be disclosed to the extent required by order of a court pursuant to section 3500 of title 18, United States Code, or rule 16 of the Federal Rules of Criminal Procedure, or other applicable discovery requirements, such court being authorized in the issuance of such order to give due consideration to congressional policy favoring the confidentiality of return and nonreturn information as set forth in this title. However, any information obtained under paragraph (1), (2), or (3) shall not be admitted into evidence in such proceeding if the Secretary determines and notifies the Attorney General or his designee or the head of such agency that such admission would identify a confidential informant or seriously impair a civil or criminal tax investigation, unless a court shall otherwise direct such disclosures."

SEC. 5. Subsection (i) of section 6103 of the Internal Revenue Code of 1954 (26 U.S.C. 6103), is amended by adding new paragraphs (5), (6), and (7) and by renumbering existing paragraphs (5) and (6) accordingly as paragraphs (8) and (9):

"(5) EMERGENCY CIRCUMSTANCES.—Under emergency circumstances involving an imminent danger of physical injury to any person, serious physical damage to property, or flight from prosecution, the Secretary or his designee may disclose information, including return information, to the extent necessary to apprise the appropriate Federal agency of such emergency. As soon as practicable thereafter, the Secretary or his designee shall notify the Department of Justice of his actions with respect to this paragraph, and the

Department shall thereupon notify the appropriate United States district court or magistrate of such disclosure pursuant to emergency circumstances.

"(6) ASSISTANCE OF IRS IN JOINT TAX AND NONTAX INVESTIGATIONS.—No portion of this section shall be interpreted to preclude or prevent the Internal Revenue Service from assisting the Department of Justice or any other Federal agency in joint tax and nontax investigations of criminal matters which may involve income tax violations, nor shall any portion of this section be interpreted to preclude or prevent the Internal Revenue Service from investigating or gathering relevant information concerning persons engaged in criminal activities which may involve income tax violations.

"(7) REDISCLOSURE TO STATE AUTHORITY OF INFORMATION OBTAINED FOR FEDERAL CRIMINAL INVESTIGATION OR PROCEEDING.—An official authorized to apply for a disclosure under section 6103(i) may make application to a district judge or magistrate for an ex parte order to disclose to the appropriate State attorney general or district attorney any return or nonreturn information in his possession which is relevant to the violation of a State felony statute. The application shall set forth the name and address of the taxpayer, the taxable period or periods to which the information relates; a description of the information sought to be disclosed; and the State felony violation involved. Such judge or magistrate may grant such order if he determines on the basis of the facts submitted by the applicant that—

"(A) there is reasonable cause to believe, based upon information believed to be reliable, that a specific State felony violation has occurred or is occurring; and

"(B) there is reasonable cause to believe that the information may be relevant to a matter relating to the commission of such violation."

SEC. 6. Paragraph (k)(4) of section 6103, Internal Revenue Code of 1954 (26 U.S.C. 6103) is amended to read as follows:

"(4) DISCLOSURE TO COMPETENT AUTHORITY UNDER INTERNATIONAL CONVENTION.—Return or nonreturn information may be disclosed to a competent authority of a foreign government which has an income tax or gift and estate tax convention, treaty on mutual assistance, or other convention relating to the exchange of tax information with the United States but only to the extent provided in, and subject to the terms and conditions of, such treaty or convention. When return or nonreturn information is sought pursuant to the terms of a treaty on mutual assistance in criminal matters for use in an investigation or proceeding not related to the tax laws of the requesting foreign country, disclosure may be made for the use of officials of the requesting country, but only after a United States district judge or magistrate issued an ex parte order that there is—

"(A) reasonable cause to believe that the information sought may be relevant to a matter relating to the commission of a specific criminal act that has been committed or is being committed against the laws of the foreign country, and

"(B) that the information is sought exclusively for use in such foreign country's criminal investigation or proceeding concerning such criminal act."

Sec. 7. Section 7213 of the Internal Revenue Code (26 U.S.C. 7213) is amended by adding a new subsection (d), as follows, and by relettering existing subsection (d) as subsection (e):

"(d) It shall be an affirmative defense to a prosecution under this section that such disclosure of return or nonreturn information resulted from a good faith, but erroneous, interpretation of section 6103 while a Federal employee was acting within the scope of his employment."

SEC. 8. Subsection (a) of section 7217 of the Internal Revenue Code (26 U.S.C. 7217) is amended to read as follows:

"(a) GENERAL RULE.—Whenever any employee of a Federal agency knowingly, or by reason of negligence, discloses return or nonreturn information (as defined in section 6102(B)) with respect to a taxpayer in violation of the provisions of section 6103, such taxpayer may bring a civil action for damages exclusively against such agency. Whenever any person other than an employee of a Federal agency knowingly, or by reason of negligence, discloses return or nonreturn information with respect to a taxpayer in violation of the provisions of section 6103, such taxpayer may bring a civil action directly against such person. The district courts of the United States shall have jurisdiction of any action commenced under the provisions of this section."

SEC. 9. (a) Subsection (b) of section 6103 of the Internal Revenue Code of 1954 (26 U.S.C. 6103) is amended by adding a new paragraph (4), as follows, and by renumbering existing paragraphs (4) through (9) accordingly:

"(4) COMBINED INFORMATION.—The term 'combined information' means any combination of taxpayer identity information, return information described in paragraph (1)(b), and, or nonreturn information described in paragraph (2)."

(b) Subsections (a), (b) (7) and (8), (d), (f), (g) (1), (3), (4), and (5), (h), (i) (6) and (7) as redesignated, (j) (3), (4), (5), and (6) of section 6103 of the Internal Revenue Code of 1954 (26 U.S.C. 6103) are amended by striking "returns or return information" and "return and return information" wherever such terms appear and inserting in lieu thereof the terms "return information and nonreturn information" and "returns and nonreturn information", as appropriate.

(c) Subsections (c), (e)(6), (g)(2), (k) (1), (3), and (6), (p) (2)(B) and (3), (c) (I) and (III), and the last sentence of subsection (d) of section 6103 of the Internal Revenue Code of 1954 (26 U.S.C. 6103) are amended by striking the term "return information" wherever such term appears and inserting in lieu thereof the term "combined information."

(d) Subsections (h) (2)(B) and (4)(B) of section 6103 of the Internal Revenue Code of 1954 (26 U.S.C. 6103) are amended by striking the word "such" and inserting in lieu thereof the word "the".

(e) Subsection (l)(1)(B) of section 6103 of the Internal Revenue Code of 1954 (26 U.S.C. 6103) is amended by striking the word "return".

(f) Subsection (b) of section 6108 of the Internal Revenue Code of 1954 (26 U.S.C. 6108) is amended by striking the term "return information (as defined in section 6103(b)(2))" and inserting in lieu thereof the term "combined information (as defined in section 6103(b)(4))".

(g) Section 7213 of the Internal Revenue Code of 1954 (26 U.S.C. 7213) is amended to strike the terms "return or return information" and "returns or return information" wherever they appear and inserting in lieu thereof the term "return and nonreturn information" and "returns and nonreturn information", as appropriate.

(h) Section 7217 of the Internal Revenue Code of 1954 (26 U.S.C. 7217) is amended to strike the terms "return or return information" and "returns or return information" wherever they appear and inserting in lieu thereof the terms "return information" or "return or nonreturn information," as appropriate.

Senator **Grassley**. I would like to call this meeting of the Subcommittee on Oversight of the Internal Revenue Service to order.

The topic of this hearing is to examine the wisdom of changing the Internal Revenue Code to allow greater disclosure of the tax information to other Government agencies for nontax criminal prosecutions.

Before we begin changing current law, we need to know what parts of the current law are not working properly. Next, we need to analyze the proposals before us to determine whether or not they solve existing problems. To assist us in this task, we have before us today a group of individuals uniquely qualified to comment on this issue.

Our first speaker will be Senator Lawton Chiles, and then after him is scheduled Senator Sam Nunn, who will be coming at about the middle of the afternoon; the Commissioner of the Internal Revenue, Roscoe Egger, Jr., accompanied by Mr. David Glickman, Deputy Assistant Secretary for Tax Policy of the Department of the Treasury; and representatives from the Department of Justice and the General Accounting Office, who have studied this issue at length will present testimony before this panel today.

I am particularly flattered that two former Commissioners of the Internal Revenue Service, Jerome Kurtz and Donald Alexander, have taken the time from their busy schedules to offer their thoughts on the effect of greater disclosure on voluntary compliance. Their critique of the legislation before us, from their vantage points as former Commissioners will be particularly useful in our consideration of this issue.

The American Civil Liberties Union and the American Chamber of Commerce will also present important comments on the operation of this legislation to the subcommittee.

Senator Nunn and Senator Chiles have studied this issue for years, and have drafted numerous bills to change section 6103 of the Internal Revenue Code. Senator Weicker has spent years opposing this effort as well. All three of these gentlemen are acknowledged experts in the field, and their testimony is of particular importance to this subcommittee.

Another participant in this hearing, recognized for his expertise, is Senator Max Baucus, ranking minority member of this subcommittee, and he was chairman of this subcommittee during the 96th Congress.

Senator Chiles, since you are here, and since you are our major spokesman on this issue, I would invite you to present your testimony at this particular time.

STATEMENT OF HON. LAWTON CHILES, U.S. SENATOR FROM THE STATE OF FLORIDA

Senator CHILES. Thank you very much, Mr. Chairman.

I want to thank you and the other members of the subcommittee for holding these hearings, and for giving us the opportunity to testify. Getting the Internal Revenue Service fully involved with other law enforcement agencies is absolutely essential if we are serious about bringing crime, and especially sophisticated, well-financed narcotics trafficking, under control.

Over 2½ years ago, the Senate Permanent Investigations Subcommittee began looking into the role IRS plays in law enforcement, with a focus on drug trafficking. Those investigations culminated in a series of hearings which underscored the seriousness of the drug trafficking problem in South Florida. The hearings also pointed out that IRS participation in stopping drug trafficking was at best minimal, and in most cases nonexistent.

I then held further oversight hearings on IRS's efforts in stopping drug trafficking in my then capacity as chairman of the Senate Appropriations Subcommittee on Treasury and Post Office. The hearings identified two causes for this lack of involvement.

First, the limits on disclosure provisions enacted as part of the Tax Reform Act of 1976 crippled the IRS's ability to cooperate with other law enforcement agencies. Second, the IRS as an institution had decided not to get involved in investigations of organized criminal activities. The IRS's attitude at that time was:

> We are the impartial collector of the taxes. We should spend as much of our time making sure a waitress has paid the tax on her tips as looking at organized crime figures or major drug traffickers.

As a result of these hearings and investigations, I joined with Senator Nunn and other Senators in introducing a bill that modified the disclosure provisions of the Tax Reform Act of 1976. That bill was designed to retain the important protections against governmental abuse of individual tax returns. But it also made changes necessary to assure that mobsters and drug traffickers could not abuse the disclosure provisions to evade criminal prosecution for their criminal activities.

We testified before this committee, and worked with the IRS and the Justice Department to refine our bill. Last December, we brought our bill before the full Senate, as an amendment to an appropriations bill, but we were defeated narrowly.

This year, we reintroduced our proposal as S. 732. In April, I joined with several other Senators and went to the White House to ask the President to support S. 732 and several other bills which taken together would make the fight against crime a top national priority.

In July, the Justice Department announced its support for the proposal, as did many of our Nation's Governors. We then brought the bill before the Senate, again, as an amendment to the Tax Reform Act. This time we were successful and the Senate did adopt the bill by more than a 2 to 1 margin.

Unfortunately, the proposal was dropped in the House-Senate conference, with the House saying that they had not held hearings on the bill, and they refused to accept our provision in the conference.

Today, we have the beginning of what I hope will be the final successful effort to enact this bill into law, and to get the Internal Revenue Service back into the fight against drug traffickers and organized criminals. Mr. Chairman, let me say again that I am delighted that you and the subcommittee are taking a leadership role in holding these hearings.

The best way to understand just how critical this bill is, is to describe the situation in my home State where the absence of IRS participation in law enforcement efforts has been a significant contributing factor in the growth of drug trafficking.

Florida has become the national port of entry and the financial capital for a multibillion dollar, illegal drug enterprise. Revenues from illegal narcotics trafficking are now estimated to amount to $10 billion a year in the State of Florida alone, making drug trafficking one of Florida's largest and most profitable enterprises.

Until recently, the vast majority of the drugs actually flowed in through Florida by planes landing at isolated airstrips or by high-speed boats taking advantage of the thousands of miles of shorefront in Florida. Recently, the amount of drugs actually being brought in through Florida has declined a bit, due in part to tough State sentencing laws.

It is not, however, a cause of relief. The smugglers have simply moved their ports of entry to some other States, in addition to Florida, along the Atlantic and gulf coast, or else their planes fly directly into the interior States. But Florida, and especially Miami, remains the financial capital of the drug world. Its proximity to South American drug producing countries, and to the Caribbean offshore banking havens where the drug money is laundered, makes it a perfect spot for large trafficking rings to set up headquarters, and they have set up those headquarters in Florida.

The effects on Miami and south Florida have been devastating. Violence is the method trafficking rings use to enforce discipline, and innocent citizens in Miami have been gunned down in shootouts between cocaine cowboys. The murder rate has skyrocketed, and Miami now has the dubious distinction of being the murder capital of the Nation. Drug dealers use their cash profits to buy up everything in sight. Luxury cars, boats, planes, and even $100,000 houses are purchased for cash, with no questions asked.

A 1979 study by the Treasury Department estimated that $4.5 billion in excess cash was deposited in the two Federal Reserve banks in Florida, most in $20 and $100 bills. These excess deposits of cash not only run totally contrary to the currency flow in the rest of the country, but they also mean that two Florida Reserve banks take in almost one-third of all the excess cash that flows in to the Federal Reserve System. Drug money is the source of this tremendous amount of cash, it is also the source of inflation in south Florida, and it has corrupted businessmen, bankers, and judicial officials.

I believe that this situation can be turned around, but changing a single law, or increasing the funding for a specific agency, will not by itself do the job. A broad attack is needed, an attack which focuses on three fronts: First, we have to work to cut off the flow of drugs into the United States; second, we have to break up the rings that control the flow; and, third, we have to make sure that our criminal justice system puts the criminals and the peddlers behind bars and keeps them there for a long time.

I am encouraged with our progress in this Congress. On the first front, stopping the flow of drugs, the Congress has moved ahead in several different areas this year. A bill to allow the military to assist law enforcement officials in tracking down smugglers' boats and planes is about to be signed into law by the President.

The Senate has voted to allow the U.S. foreign assistance to be used for drug crop eradication programs overseas. So we have removed the prohibition on the use of paraquat. The Senate has approved $100 million in special funds for the Coast Guard to be used to purchase needed equipment.

On the third front, reforming our criminal justice system, there have been encouraging signs of progress, with the Senate Judiciary Committee moving forward with needed reforms in the bail bond laws, with tough sentencing provisions for drug traffickers and for violent criminals.

The key component of the second prong of this attack, breaking up the drug smuggling rings, requires the use of sophisticated financial investigations to uncover the drug kingpins. The people at the top of these organizations have placed layers of people between themselves and the sale of the drugs, or the delivery of the drugs.

We are never going to pin that on them, as long as we arrest those people at the sale or delivery level. These are soldiers and you can replace them 10 for 1. The only way we are going to get the people at the top is by being able to trace the money. If we are to catch these people and break up the rings, we have to focus on the money, on the suitcases of cash, the laundering operations, and the large cash purchases.

Mr. Chairman, we all know that no agency is better equipped to find the money than the Internal Revenue Service. They have shown their expertise and ability in the past. Al Capone, the only way we ever put him into prison was for tax evasion, with all of the people that he killed and all of the laws that he broke.

Yet, today, the IRS has been unable to help, and a major reason for this lack of help has been the Tax Reform Act of 1976, and the limit it places on the disclosure of nontax criminal information.

The disclosure provisions of the Tax Reform Act were drafted with an eye toward preventing abuses of taxpayer privacy by the IRS and other Federal agencies. Such abuses had occurred during the Watergate era, when the White House and the IRS made such disclosures for highly questionable purposes. In practice, however, the Tax Reform Act provisions have been interpreted so strictly that disclosure of evidence of nontax criminal activities is virtually impossible.

The General Accounting Office has reported that the IRS literally has a file drawer full of evidence of Federal nontax crime that it is prohibited from turning over to the Justice Department.

In those instances where the IRS has been able to work with other agencies, the procedural requirements of the current disclosure law have created such time delays that the information loses its value, and in Senator Nunn's words, "We have a sledgehammer to kill an ant."

The current law has created a catch-22 situation. IRS agents are prohibited from telling other law enforcement officials about the criminal evidence they have gathered in their normal course of operation. To obtain that information, a Federal prosecutor has to get a court order.

The courts require that the prosecutor make a request for specific information in great specificity to get that court order. But since the IRS agents cannot tell the prosecutor of the information that they hold, he is unable to make that specific request with such specificity to meet the test.

Moreover, if the tax returns are requested, they must be the most probative evidence of the crime that the prosecutor is investigating. Remember, we are talking about nontax crimes, and it is highly unlikely that the tax information would ever be the most probative evidence of a nontax crime such as drug trafficking, and the result is an impossible standard to satisfy.

S. 732 would eliminate this catch-22 situation, yet still maintain the protections needed to prevent abuses. As in current law, S. 732 requires a prosecutor to get a court order to obtain information from the IRS. The prosecutor must show that the information he seeks is relevant to a crime, and that the information will be used solely in the investigation and prosecution of that crime. This new test is similar to the test a prosecutor must meet if he seeks a wiretapping order from the court.

The bill would promote greater IRS cooperation with the the Justice Department and other investigative agencies by requiring IRS to turn over certain types of criminal evidence, such as bank records that it obtains, to the Justice Department This helps eliminate the catch-22 provision.

Finally, the bill makes changes in the penalty provisions, changes which will promote closer cooperation in joint investigations.

Mr. Chairman, the Tax Reform Act of 1976 was intended to insure the privacy of returns, and of course to prevent Government abuse of taxpayer information, as is S. 732. It gives no additional authority or power to the IRS to gather information about ordinary taxpayers. It strengthens current protections by specifying that only one agency, the Justice Department, is permitted to obtain tax information. It retains the court order requirement for tax returns.

However, S. 732 also recognizes that the IRS must have the ability to work with other Federal law enforcement agencies to bring those who earn their money through time to justice. The need for IRS cooperation and IRS expertise is at its greatest when criminals are the ringleaders of drug trafficking rings and organized mobsters.

In closing, I would like to read from a speech given by former Attorney General Civiletti. He stated:

> Before the Tax Reform of 1976, financial information in the possession of the Internal Revenue Service—information filed by taxpayers as well as information collected by the service in the course of its audits and investigation—was an important resource for criminal investigators and prosecutors in the Justice Department. Money is the medium in which most crimes are transacted, and this is especially true of the Federal crimes that merit the greater part of our investigatory effort—organized crime, and white collar crime and narcotics trafficking. Before the Tax Reform Act of 1976, financial information in the possession of the Internal Revenue Service helped us to piece together and prove in court the paper trials—the illicit financial transactions—that are characteristic of these crimes. Moreover, the skilled personnel of the Internal Revenue Service were and still are the best and most numerous financial investigators in the Federal government, and in the Tax Reform Act of 1976 we relied upon them heavily to unravel the complex transactions that conceal both tax and non-tax crimes. But the disclosure restrictions imposed by the Tax Reform Act of 1976 have limited our access both to the financial information in the possession of the IRS and to the assistance of these experts.

Mr. Chairman, the task of pursuing and prosecuting the drug smuggler is difficult enough without first having to face the challenge of penetrating what Mr. Civiletti called the "wall of secrecy" between the IRS and the Justice Department.

If we are to reverse our current failure to contain the drug trafficking trade, there can be no higher priority than insuring that the full resources of the Federal Government are dedicated to fighting this problem. The IRS, with its unmatched expertise, resources, and information, has to be a full partner in this effort, and making the IRS a full partner in this fight is something that we in Congress can and must do.

That is exactly what we have done, Mr. Chairman, in amending the statute on Posse Comitatus to allow us to use the full source of resources of radar and satellite information of the Army and the military in trying to provide that information. Now we have got to see that we use all of the tools at our hands in regard to the Internal Revenue Service.

I have a copy of some of the information made available to us from the GAO study, and I would submit that with my statement, if I might.

Senator **Grassley**. Without objection, it will be included in the record.

[Statement of Senator Chiles, and GAO information follow:]

STATEMENT
of
SENATOR LAWTON CHILES
ON S. 732,
a bill to amend the Tax Reform Act of 1976

SUBCOMMITTEE ON OVERSIGHT OF THE INTERNAL REVENUE SERVICE
SENATE FINANCE COMMITTEE
November 9, 1981

TESTIMONY OF SENATOR LAWTON CHILES

Mr. Chairman, I want to thank you and the other members of the Subcommittee for holding these hearings, and for giving me the opportunity to testify. Getting the Internal Revenue Service fully involved with other law enforcement agencies is absolutely essential if we are serious about bringing crime -- especially sophisticated, well financed narcotics trafficking -- under control.

Over two and a half years ago, the Senate Permanent Investigation Subcommittee began to look into the role IRS plays in law enforcement, with a focus on drug trafficking. Those investigations culminated in a series of hearings which underscored the seriousness of the drug trafficking problem in South Florida. The hearings also pointed out that IRS participation in stopping drug trafficking was, at best minimal, and, in most cases non-existant. I then held further oversight hearings on IRS's efforts in stopping drug trafficking in my capacity as Chairman of the Senate Appropriations Subcommittee on the Treasury and Post Office. The hearings identified two causes for this lack of involvement. First, the limits on disclosure provisions enacted as part of the

Tax Reform Act of 1976 crippled the IRS's ability to co-operate with other law enforcement agencies. Second, the IRS, as an institution, had decided not to get involved in investigations of organized criminal activities. The IRS's attitude remained: "We plan to spend just as much time investigating a waitress who's trying to cheat on her tips as we will spend going after sophisticated criminals."

As a result of these hearings and investigations, I joined with Senator Nunn and other Senators in introducing a bill that modified the disclosure provisions of the Tax Reform Act of 1976. The bill was designed to retain the important protections against governmental abuse of individual tax returns. But it also made changes necessary to assure that mobsters and drug traffickers could not abuse the disclosure protections to evade prosecution for their criminal activities. We testified before this Committee, and worked with the IRS and the Justice Department to refine our bill. Last December, we brought our bill before the full Senate, as an amendment to an appropriations bill, but were defeated.

This year, we re-introduced our proposal as S. 732. In April, I joined with several other Senators and went to the White House, to ask the President to support S. 732 and several other bills which, taken together, make the fight against crime a top national priority. In July, the Justice Department announced its support for the proposal, as did many of our nation's governors. We then brought the bill before the Senate again, as an amendment to the Tax Reform Act. This time we were successful, and the Senate adopted the bill by more than a 2 to 1 margin. Unfortunately, the proposal was dropped in the

House Senate conference.

Today however, we have the beginning of what I hope will be the final, successful effort to enact this bill into law, and to get the IRS back into the fight against drug traffickers and organized criminals. Mr. Chairman, let me say again that I am delighted that you and the Subcommittee are taking a leadership role in holding these hearings.

The best way to understand just how critically this bill is needed is to describe the situation in my home state of Florida, where the absence of IRS participation in law enforcement efforts has been a significant contributing factor in the growth of drug trafficking.

Florida has become the national port of entry and the financial capital for a multi billion dollar, illegal drug enterprise. Revenues from illegal narcotics trafficking are now estimated to amount to $10 billion a year in Florida alone, making drug trafficking one of Florida's largest and most profitable enterprises. Until recently, the vast majority of drugs actually flowed in through Florida, by planes landing at isolated airstrips, or by high speed boats taking advantage of the thousands of miles of shorefront in Florida. Recently, the amount of drugs actually being brought in through Florida has declined a bit, due in part to tough state sentencing laws. It is not however a cause for relief. The smugglers have simply moved their ports of entry to other states along the Atlantic and Gulf Coasts, or else they fly planes directly into the interior states. But Florida, and especially Miami, remains the financial capital of the drug world. Its proximity to the South American drug producing countries, and to the Caribbean offshore banking havens where the drug money is laundered, makes it a perfect spot for the large trafficking rings to set up headquarters.

And they have set up headquarters.

The effects on Miami and South Florida have been devasting. Violence is the method trafficking rings use to enforce discipline, and innocent citizens in Miami have been gunned down in shootouts between cocaine cowboys. The murder rate has skyrocketed, and Miami now has the dubious distinction of being the murder capital of the nation. Drug dealers use their cash profits to buy up everything in sight. Luxury cars, boats, planes and even hundred thousand dollar houses are purchased for cash, no questions asked.

A 1979 study by the Treasury Department estimated that $4.5 billion in excess cash was deposited in the two Federal Reserve banks in Florida, mostly in 20 and 100 dollar bills. These excess deposits of cash not only run totally contrary to the currency flow in the rest of the country. They also mean that two Florida federal reserve banks take in almost one third of all the excess cash flowing into the federal reserve system. Drug money is the source of this tremendous amount of cash. It is also the source of inflation in south Florida, and it has corrupted businessmen, bankers and law enforcement officials.

I believe that this situation can be turned around. But changing a single law, or increasing the funding for a specific agency, will not, by itself, do the job. A broad attack is needed, an attack which focuses on three fronts: first, we have to work to cut off the flow of drugs into the United States; second, we have to break up the drug trafficking rings that control the flow; and third, we have to make sure that our criminal justice system puts the drug peddlers and organized criminals behind bars.

I'm encouraged with our progress in this Congress. On the first front, stopping the flow of drugs, the Congress has moved ahead in several different areas this year. A bill to allow the military to assist law enforcement officials in tracking down smugglers' boats and planes is about to be signed into law by the President. The Senate has voted to allow U.S. foreign assistance to be used for drug crop eradication programs overseas. The Senate has approved $200 million in special funds for the Coast Guard, to be used to purchase needed equipment. On the third front, reforming our criminal justice system, there have been encouraging signs of progress. The Senate Judiciary Committee is moving forward with needed reforms in the bail bond laws, with tough sentencing provisions for drug traffickers and for violent, criminals.

The key component of the second prong of this attack -- breaking up the drug smuggling rings -- requires the use of sophisticated financial investigations to uncover the drug kingpins. The persons at the top of these organizations have placed layers of people between themselves and the actual drugs. When a person is arrested for smuggling drugs, the organization continues, no matter how large the amount of drugs seized. The drugs seized amount to a temporary business loss, which the organization can make up in a matter of weeks or months. And there will be others ready to step in and take the place of those who were arrested. The people at the top are never caught.

There is only one reason why the people at the top are involved, and that is money. And if we are to capture these people and break up the trafficking rings, we must focus on the money, on the suitcases of cash, the laundering operations and the large cash purchases. And Mr. Chairman, we all know that no agency is better equipped to find the money than the Internal Revenue Service. They have shown their expertise and ability in the past. Al Capone was put into prison for tax evasion, not for murder or robbery or bootlegging. Yet today, the I.R.S. has been unable to help.

A major reason for this lack of help has been the Tax Reform Act of 1976, and limits it places on the disclosure of non tax criminal information.

The disclosure provisions of the Tax Reform Act were drafted with an eye towards preventing abuses of tax payer privacy by the IRS and other federal agencies. Such abuses had occured during the Watergate era, when the Nixon White House and the IRS made such disclosures for highly questionable purposes. In practice however, the Tax Reform Act provisions have been interpreted so strictly that disclosure of evidence of non tax criminal activities has become virtually impossible.

In fact, the GAO reported that the IRS literally has a file drawer full of evidence of federal non tax crime that it is prohibited from turning over to the Justice Department. In those instances where the

IRS has been able to work with other agencies, the preceduaral requirements of the current disclosure law have created such time delays that the information loses its value. In Senator Nunn's words, "We've used a sledge hammer to kill an ant."

The current law has created a Catch 22 situation. IRS agents are prohibited from telling other law enforcement officials about the criminal evidence they have gathered in their normal course of operations. To obtain that evidence, a federal prosecutor must get a court order. The courts require that the prosecutor make a request for specific information to get a court order. But since IRS agents cannot tell the prosecutor waht evidence is available, the prosecutor is unable to make a specific request. Moreover, if tax returns are requested, they must be the most probative evidence of the crime that the prosecutor is investigating. Remember, we are talking about non tax crimes. It's highly unlikely that tax information would ever be the most probative evidence of a non tax crime such as drug trafficking. The result is an impossible standard to satisfy.

S. 732 would eliminate this Catch 22 situation, yet still maintain the protections needed to prevent abuses. As in current law, S. 732 requires a prosecutor to get a court order to obtain information from the IRS. The prosecutor must show that the information he seeks is relevent to a crime, and that the information will be used solely in the investigation and prosecution of that crime. This new test is similar to the test a prosecutor must meet when he seeks a wiretapping order from the court.

The bill would promote greater IRS cooperation with the Justice Department and other investigative agencies, by requiring the IRS to turn over certain types of criminal evidence such as bank records it obtains to the Justice Department. This helps eliminate the Catch 22 situation. Finally the bill makes changes in the penalty provisions, changes which will promote closer cooperation and joint investigations.

Mr. Chairman, the Tax Reform Act of 1976 was intended to insure the privacy of tax returns, and to prevent government abuse of tax payer information. So is S. 732. S. 732 gives no additional authority or power to the IRS to gather information about ordinary taxpayers. It strengthens current protections by specifying that only one agency, the Justice Department, is permitted to obtain tax information. It retains the court order requirement for tax returns. But S. 732 also recognizes that IRS must have the ability to work with other federal law enforcement agencies to bring those who earn their money through crime to justice. The need for IRS cooperation and IRS expertise is greatest when the criminals are the ringleaders of drug trafficking rings and organized mobsters.

In closing, I would like to read from a speech given by former Attorney General Civiletti. He stated:

> "Before the Tax Reform Act of 1976, financial information in the possession of the Internal Revenue Service -- information filed by taxpayers as well as information collected by the Service in the course of its audits and investigation -- was an important resource for criminal investigators and prosecutors in the Justice Department. Money is the medium in which most crimes are transacted, and this is especially true of the federal crimes that merit the greater part of our investigatory effort -- organized crime, and white collar crime and narcotics trafficking. Before the Tax Reform Act of 1976, financial information in the possession of the Internal Revenue Service helped us to peice together and prove in court the paper trails -- the illicit financial transactions -- that are characteristic of these crimes. Moreover, the skilled

> personnel of the Internal Revenue Service were and still are the best and most numerous financial investigators in the Federal Government, and before the Tax Reform Act of 1976 we relied upon them heavily to unravel the complex transactions that conceal both tax and nontax crime. But the disclosure restrictions imposed by the Tax Reform Act of 1976 have limited our access both to the financial information in the possession of the IRS and to the assistance of these experts."

Mr. Chairman, the task of pursuing and prosecuting the drug smuggler is difficult enough without first having to face the challenge of penetrating what Mr. Civiletti called the "wall of secrecy" between the IRS and the Justice Department. If we are to reverse our current failure to contain the drug trafficking trade, there can be no higher priority than insuring that the full resources of the Federal government are dedicated to fighting this problem. The IRS, with its unmatched expertise, resources and information, must be a full partner in that effort. And making the IRS a full partner in this fight is something that we in Congress can do, and must do.

Thank you.

BY THE COMPTROLLER GENERAL

Report To The Congress

OF THE UNITED STATES

Gains Made In Controlling Illegal Drugs, Yet The Drug Trade Flourishes

This report assesses the Federal Government's drug enforcement and supply control efforts during the last 10 years, including information contained in a series of GAO reports issued on drug control and various related topics during this time.

Federal agencies have fought hard to reduce the adverse impact of illegal drugs on American society. While current indicators suggest some positive results in reducing drug-related deaths and injuries and decreasing heroin supplies, the drug trade continues to flourish, and the problem persists for reasons tied to the enormous supply of and demand for drugs.

Effective law enforcement, crop eradication, and other controls will cause shifts and temporary disruptions in trafficking and use patterns, and buy time to enable the Nation to concentrate on long-term solutions. But if the United States is to make greater inroads, it must take a much tougher and consistent stance. The executive and legislative branches must form a partnership to agree upon and vigorously carry out a consistent national policy on drug abuse.

UNITED STATES GENERAL ACCOUNTING OFFICE

GGD-80-4
OCTOBER 25, 1979

- Coordination and communication among CSUs, necessary for developing interstate and international conspiracy cases, was not effectively established.

During our visits to several U.S. attorney's offices we found specific examples of the situations related by the Department of Justice (DOJ) Internal Audit Report. For instance, in San Francisco, Assistant U.S. attorneys and DEA personnel acknowledged that, up until recently, CSU efforts were not very effective at developing and prosecuting major conspiracy cases. In Chicago, all types of drug cases are handled by the U.S. attorney's narcotics unit, which is generally staffed by attorneys with little trial experience. Although some of the more complex drug cases are handled by attorneys outside the unit to take advantage of their experience, these attorneys are not assigned full-time to narcotics. In Miami, the lack of CSU emphasis on major conspiracy cases prompted NDDS to assign two of its staff attorneys to work with DEA in the investigation and prosecution of several large-scale trafficking organizations.

Effective drug enforcement requires an unusually high degree of communication and coordination among agencies, and conspiracy cases against the top level drug financiers require, additionally, sophistication and a marshalling of available resources. CSU attorneys occupy the best position to accomplish this oversight and coordination through their early involvement in conspiracy case investigations. For this to happen, however, the parochialism and individual prosecution practices of U.S. attorneys will have to be tempered, and the Justice Department's nationwide drug prosecution strategy strengthened. Several alternatives for doing this are: increasing Justice Department (NDDS) control over CSU activities; establishing drug prosecution units independent of the U.S. attorneys' offices, similar to the organized crime strike forces; or implementing uniform prosecutive priorities among the various Federal judicial districts to assure consistent commitment to high-level drug prosecutions.

IRS' ROLE IN DRUG ENFORCEMENT IS LIMITED

The President and Members of the Congress have stressed in recent years the need to use the tax laws and IRS' financial expertise in investigating major drug traffickers. With the increased emphasis on conspiracy and financial investigations, the value of tax and tax-related information, as well as IRS' financial expertise, is obvious. However, the Tax Reform Act of 1976 placed certain restrictions on IRS which limit its ability to assist drug enforcement efforts.

The intent of the Congress, in enacting the Tax Reform Act of 1976, was to afford taxpayers increased privacy over information they provided IRS and additional civil rights in summons matters. In our March 1979 report, 1/ we pointed out that the new legal provisions have had their desired effect, although implementation of the act has caused some time delays and coordination problems between IRS and other Federal law enforcement agencies. In our opinion, the adverse impact on the law enforcement community, as a result of the disclosure provisions, had not been sufficiently demonstrated to justify changing the law. Nevertheless, the types of coordination problems being experienced illustrated the need for better coordination within the framework of existing law. The Congress needs to consider whether the adverse impacts warrant revision of the legislation and whether any revision can be made without disrupting the balance between criminal law enforcement and an individual's rights.

IRS efforts against drug traffickers have varied in recent years. The Narcotics Traffickers Program (NTP) was established at President Nixon's direction in 1971 to disrupt the narcotics distribution system through intensive tax investigations of middle and upper echelon drug dealers. By 1975, however, the NTP had been dismantled because IRS exceeded its cash-seizing authority and because of the program's low revenue yield. The Commissioner of Internal Revenue also believed that the public's trust in the IRS as an impartial administrator of the tax laws is vital and could be jeopardized when IRS is assigned missions whose primary objectives are not tax-related. The NTP activities were subsequently integrated into the Service's regular tax enforcement efforts, and the practice of seizing drug-related cash was severely restrained.

In 1976 President Ford directed IRS to again establish a tax program aimed at high-level drug traffickers. In a message to the Congress, he expressed confidence that a reasonable program could be designed to promote effective enforcement of the tax laws against individuals who were violating them with impunity. Consequently, the heads of IRS and DEA

1/"Disclosure and Summons Provisions of 1976 Tax Reform Act--Privacy Gains With Unknown Law Enforcement Effects" (GGD-78-110, Mar. 12, 1979).

signed a Memorandum of Understanding, and IRS implemented its High-Level Drug Leaders Tax Enforcement Project.1/ The House Select Committee on Narcotics Abuse and Control found, however, that the program actually provides no greater emphasis on narcotics traffickers than on any other taxpayer group.

Whatever the effectiveness of the IRS High-Level Drug Leaders Tax Enforcement Project, the Tax Reform Act of 1976 restricts the extent to which IRS can get involved in drug enforcement. The act reflects the Congress' intent to tighten the rules governing IRS' disclosure of tax information. It is consistent with the policy of the former Commissioner of Internal Revenue that IRS, while participating in activities such as strike forces and NTTP, focus its efforts on tax administration matters, with a view toward avoiding the abuse of certain IRS powers in the future. Among other things, the act affords taxpayers increased privacy over information they provide IRS by placing substantial restrictions on other Government agencies' rights of access to tax information, with stringent criminal and civil penalties for unlawful disclosure.

For nontax criminal cases the heads of certain Federal agencies, including the Department of Justice, can gain access to tax information that IRS had obtained from third parties by submitting a written request to the Secretary of the Treasury specifying the taxpayer's name and address, the tax periods involved, the statutory authority under which the agency head is proceeding, and the specific reason why the tax information is needed. They can gain access to information IRS had obtained from taxpayers, including tax returns and associated information, by obtaining a Federal district court order.

In a letter to GAO dated November 13, 1978, commenting on a draft of our report on the effects of the disclosure and summons provisions of the 1976 Tax Reform Act, the Department of Justice was critical of the act. Justice stated that the act is primarily responsible for the Department's utilization of tax information dropping to a fraction of pre-1977 levels. According to Justice, the significant decline in access to evidence of criminal activity demonstrates the severe adverse impact of the act upon law enforcement when considered in light of the major role which tax information has historically played in prosecutions of white-collar and organized crime, public corruption, and

---

1/Also referred to as the Narcotics Trafficker Tax Program (NTTP).

narcotics trafficking. The Department added that it is unavoidable that reduced access to tax information impedes law enforcement effectiveness in controlling these high priority areas of law enforcement.

The Justice Department further stated that the initial effect of the act's disclosure provisions was to cause a "virtual collapse" in coordination between IRS and Justice. Justice believes that although this situation has improved somewhat with experience, coordination is and will continue to be greatly diminished. It said one aspect of reduced coordination is that other law enforcement agencies have less access to IRS expertise in the analysis of financial records so crucial to complex prosecutions.

In our visits throughout the country on this review, many DEA officials and Federal prosecutors expressed similar views about the act's disclosure provisions. The types of problems being experienced were presented in our March 1979 report, and included the following:

--IRS cannot always disclose information about nontax crimes. In conducting their daily activities, IRS employees sometimes obtain information indicating that a particular taxpayer has committed a crime outside IRS' jurisdiction. If such information is obtained by IRS from a third party, IRS can take the initiative in disclosing the information to the head of the appropriate Federal agency including the Attorney General. However, if that information is obtained from a taxpayer, his records, or his representative, IRS cannot alert the Attorney General or other Federal agency heads regardless of the crime's seriousness.

--IRS cannot alert Justice attorneys to seek disclosure of criminal tax information. A coordination problem arises when IRS has criminal tax information on an individual which can be useful to a U.S. attorney or a Strike Force attorney, and the affected attorney does not know IRS has the information. In this regard, the Tax Reform Act prohibits IRS from initiating discussions with Justice attorneys about a person's criminal tax affairs until IRS officially refers its case to Justice for prosecution. As a result, Justice attorneys believe that the Tax Reform Act has adversely affected their ability to properly carry out their duties as Federal prosecutors and law enforcement coordinators.

- --IRS apparently takes more time to respond to Justice requests for tax information. But Justice was unable to provide us with examples of specific problems caused by IRS' response time. Before enactment of the Tax Reform Act, IRS had little cause to question the validity of requests for tax data made by U.S. attorneys, Strike Force attorneys, and other Department of Justice officials. The time needed to respond to such requests, therefore, would have been minimal. Since the disclosure provisions became effective, however, IRS has had to evaluate the propriety of each request and ensure that all applicable legal requirements have been satisfied. In light of these new concerns, an increase in IRS' response time would not be unexpected. Justice, however, has expressed concern about the delays its attorneys encounter when seeking tax information.

- --Coordination between IRS and DEA has been slowed. Once the disclosure provisions became effective, implementation of the IRS High-Level Drug Leaders Tax Enforcement Project was slowed due to disclosure-related questions about the legality of and the methodology to be used under the IRS/DEA agreement governing the project's operation. However, the Tax Reform Act did not render the agreement obsolete. For example, in September 1977, DEA requested, through an Assistant Attorney General, access to third party tax information of 798 alleged high-level drug dealers. IRS authorized that access in letters dated October, November, and December 1977.

The above examples indicate that the disclosure provisions have had some adverse effects, but, in our opinion, the record of those effects is insufficient to warrant recommending changes to the law. In this regard, we recognize the need to strike an appropriate balance between criminal law enforcement and an individual's right to privacy. That balance is particularly important in tax administration because taxpayers should be able to satisfy their income tax obligations with the knowledge that information they provide IRS will be used only as authorized by law. The types of coordination problems being experienced, however, point up the need for better coordination within the framework of existing law. The Congress needs to consider whether the adverse impacts on Federal law enforcement activities warrant revision of the legislation and whether any revision can be made without disrupting the balance between criminal law enforcement and an individual's rights.

FBI ATTACK ON ORGANIZED DRUG CRIME HAS YET TO BE REALIZED

It is widely believed that the FBI has acquired considerable expertise and intelligence in investigating both organized crime and the financial aspects of criminal activity, two areas that have been shown to be inextricably linked to the drug traffic. Although the agency's role in support of drug enforcement has never really been clear, there is today more interchange between DEA and the FBI than in the past. Much of this increased level of activity, however, had not shown significant results as of mid-1979.

At the time of hearings on Reorganization Plan No. 2 of 1973, various statements were made about FBI involvement in drug law enforcement. The plan itself is not specific, and merely requires the Attorney General to provide for maximum cooperation between the FBI and DEA on drug law enforcement and related matters. The Presidential message transmitting the plan calls for "a more effective anti-drug role for the FBI, especially dealing with the relationship between drug trafficking and organized crime." The Subcommittee of the Senate Committee on Government Operations, in its report on the plan, was more specific in its comments on an expanded FBI role. It recommended such things as a close working relationship in the use of informants, daily headquarters liaison at high levels, access to each other's intelligence memos, and the sharing of laboratory and training facilities as well as selected case records. In our December 1975 report on Federal drug enforcement 1/, however, we concluded that the FBI role needed to be clarified if more is expected than the exchange of information and intelligence at the operating level.

1/"Federal Drug Enforcement: Strong Guidance Needed" (GGD-76-32, Dec. 18, 1975).

DISCLOSURE TO COMPETENT AUTHORITY UNDER INTERNATIONAL CONVENTIONS AND TREATIES

26 U.S.C. §6103	S.732
(K)(4) Disclosure of tax information to foreign governments to extent authorized under tax conventions.	(K)(4) Adds an authorization for the disclosure of tax information to extent authorized under mutual assistance treaties. Requires ex parte court order for disclosure of information involving non-tax criminal matters under mutual assistance treaties, based on finding that (i) on the basis of reliable information, there is reasonable cause to believe a crime has been or is being committed; (ii) information is sought exclusively for use in a Federal criminal proceeding; and (iii) reasonable cause to believe information is relevant.

GAO Comments

This provision provides a needed mechanism to allow the Government to perform according to mutual assistance treaties it has entered into with foreign governments to exchange criminal evidence. Under S.732, a court order is required for all disclosures, which we believe adequately accomodates privacy concerns. Also, it should be noted that under mutual assistance treaties generally, evidence exchanged with foreign governments must relate to criminal acts which are considered crimes in both countries involved, and there is considerable discretion provided in the treaties not to disclose any information which would be contrary to the public interest of the governments involved. These safeguards should protect against abusive disclosures.

CRIMINAL PENALTY PROVISION: COMPARISON OF 26 U.S.C. §7213 and S.732

26 U.S.C. §7213	S.732
Provides criminal penalties for unauthorized disclosure of tax information.	Adds an affirmative defense to a prosecution under this section: i.e., that the disclosure resulted from a good faith but erroneous interpretation of the law.

GAO Comments

Enactment of S.732 would make clear that criminal sanctions attach only in the case of intentional violations of the disclosure provisions.

CIVIL PENALTY PROVISION: COMPARISON OF 26 U.S.C. §7217 and S.732

26 U.S.C. §7217	S.732
Authorizes the payment of civil damages to a taxpayer by the individual responsible for unauthorized disclosures of tax information.	When unauthorized disclosure is made by Federal employee, the Government, rather than the individual employee, is responsible for payment of civil damages.

GAO Comments

The Government would be civilly liable under S.732 for all unauthorized disclosures made by Federal employees, including those made intentionally and with knowledge of the disclosure restrictions. However, this would not affect the Government's ability to proceed criminally against employees who intentionally violate section 6103.

Senator GRASSLEY. You have put almost total emphasis on the need for the legislation as a tool against drug smuggling and drug trafficking.

Senator CHILES. Mr. Chairman, I guess because Florida is hit so hard with that, I tend to come down on that. I think it has an equal merit in any organized crime activity.

Senator GRASSLEY. That answers the question I was going to ask. But I also would, then, ask, why would you think of limiting it to the number suspected crimes; let's suppose that we would just limit it to drug traffic?

Senator CHILES. If I thought that was the only way we were going to get this legislation passed, I would have to say that it is of such importance to Florida, I would not turn down having the opportunity to do that.

But I have a very hard time rationalizing that if you or I conceal information about a crime, that is the commission of a crime itself. Why in the world should we have a Government agency, who knows it has the information about a crime, and then have no basis on which they can disclose or carry that information on.

The example that we often used to carry this to its extreme is that today, under the IRS interpretation of the Privacy Act, if in a routine tax audit they came across a plot to assassinate the President of the United States, they would be prohibited by law by sharing that plot.

Why should we say that they can target drug offenders, but could not perhaps protect the life of the President of the United States? I would have a hard time rationalizing that.

Senator GRASSLEY. Senator Baucus, why don't you ask questions, and then I will call upon you for an opening statement, after Senator Chiles has completed and has left.

Senator BAUCUS. Senator Chiles, I appreciate very much your efforts in this area. All of us are trying to find ways to crack down on drug abuse, drug peddling, and organized crime.

You made a statement, though, that I would like to clarify, the last statement you just made. It is my understanding that under present law, if the IRS, through a routine tax audit, discovers some information that looks like a violation or crime, that they may disclose that information, according to their discretion, to the appropriate Federal agency. Isn't that the present law?

Senator CHILES. No, sir. The way that would work is that the other agency has to make the request to them, and it has to make it in such specificity that they make the information available to them. That is the catch-22 situation that we are faced with.

Senator BAUCUS. I think we can clarify what the law is and what the law is not on that point.

Senator CHILES. Yes.

Senator BAUCUS. My basic problem, which I am sure is one of your problems as well, I also want to make sure that we encourage the public cooperation with IRS.

Senator CHILES. Yes.

Senator BAUCUS. We want to make sure that the voluntary nature of our tax collection system continues, that people voluntarily disclose all relevant information on the taxpayer's tax status to the IRS. We don't want any significant chilling effect here.

Our concern, obviously, is that while trying to accomplish one goal, stamping out organized crime, we might be causing other problems.

Senator CHILES. Yes. That was not the purpose for the passage of the 1976 amendment, though, I think you know. The purpose of the Privacy Act was to protect the privacy of taxpayers because at that time we were concerned about abuse, primarily from the executive branch, from the President targeting somebody and saying, "I want you to go after that person."

That was the purpose. It was not because we were worried about a chilling effect at that time. At that time, when they could make disclosure and did, I don't know that there was any problem in getting the voluntary compliance of the taxpayer. On any event, that was not the purpose for passing the act.

Senator BAUCUS. Under S. 732, if an agency wants certain informtion from the IRS, what must the agency do in order to get that information?

Senator CHILES. One of the different provisions is that if they come across a crime, they now have to blow the whistle, they have to notify the Justice Department.

Senator BAUCUS. That is not my question. My question really goes to what does the agency do, if they want the information, go to the Attorney General's office?

Senator CHILES. I don't have all of the details, and we will supply those to you. But they, in effect, must show that that information would be of assistance to them in prosecuting a Federal crime, and it is the Justice Department that must show that. They must have a hearing before a Federal judge, and the Federal judge must determine that he feels that the evidence would be relevant before it is released to them.

Senator BAUCUS. I did not mean to ask the question with such specificity, but it is your understanding that the Federal agency must show (a) that the information sought is relevant?

Senator CHILES. That is right.

Senator BAUCUS. And (b) what?

Senator CHILES. That it shows the commission of a Federal crime, and that the information would be relevant to proving that crime.

Senator BAUCUS. Under present law, the agency must (a) show that there is reasonable cause to believe that a specific criminal act has been committed.

Senator CHILES. That is right.

Senator BAUCUS. And (b) the return and related information is probative evidence of that act.

Senator CHILES. Yes.

Senator BAUCUS. And (c) that the information is relevant.

Senator CHILES. One of the differences now——

Senator BAUCUS. What are the essential differences?

Senator CHILES. One of the differences is that now they have to show that what the IRS has is the most probative evidence. As we said, in many drug transactions, it is not the most probative evidence. So if you have to meet that test, often you cannot meet it. So we would strike that, that it has to be the most probative evidence.

Senator **Baucus**. You may not have this information, but how many requests has the Government made under present law to get taxpayer return information specifically in order to prosecute some organized crime, or some drug crime, but where the judge has refused to grant the information? How many times has that occurred?

Senator **Chiles**. I don't have that. We can supply some of that for you.

In our hearings, what happened was, and what we found out, we had U.S. attorneys testify, and they said that it became so complex that when they could not get the information, they quit making the requests. They quit attempting to even try.

The General Accounting Office did look at the number of cases that IRS, some 700 or 800 cases, where there was evidence of crimes that they were sitting on, that they had not disclosed.

Senator **Baucus**. Perhaps, if some other witness has the information, it would be helpful to know the number of cases where a law enforcement official attempted to get the information but where a judge denied it.

Senator **Chiles**. Our hearing record will show some glaring examples of where they did attempt to get information and couldn't in some cases that were not disclosed. I think you will find, as far as the numbers being great, once they couldn't get them, and once it took so long—they would tell us time after time that it took so long, by the time they could go through the maze, through the process, the information was no longer of any value to them because it was so stale, and they just quit trying.

Senator **Baucus**. Thank you, Mr. Chairman.

Senator **Grassley**. Senator Chiles, I have no further questions. Thank you very much for your testimony.

I will call Commissioner Egger now, and Deputy Assistant Secretary of Treasury David G. Glickman.

I would also like to tell you, Commissioner Egger, as well as any witnesses that come after you that if Senator Nunn comes, and he desires to be heard immediately, I may ask you to delay your testimony to receive his.

Then, I would also like to ask Senator Baucus if he has an opening statement that he wants to make.

Senator **Baucus**. Thank you, Mr. Chairman, I do have a statement that I would like to have made part of the record in order to save time.

[Opening statement of Senator Baucus follows:]

OPENING STATEMENT OF SENATOR MAX BAUCUS
BEFORE THE FINANCE SUBCOMMITTEE ON OVERSIGHT OF THE INTERNAL REVENUE SERVICE

NOVEMBER 9, 1981

IRS DISCLOSURE LEGISLATION

MR. CHAIRMAN, I HAVE ONLY A FEW BRIEF OPENING REMARKS TO OFFER. I HAVE ADDRESSED THE LEGISLATION BEFORE US ON A NUMBER OF OTHER OCCASIONS. MY CONCERNS ARE WELL KNOWN TO THE PARTICIPANTS IN THIS HEARING.

I UNDERSTAND AND RECOGNIZE SENATOR NUNN'S POSITION. AND, I COMMEND HIM FOR HIS VERY DILIGENT EFFORTS IN THIS AREA.

NEVERTHELESS, THE LEGISLATION BEFORE US TODAY DOES TROUBLE ME. WE MUST STRIKE, I BELIEVE, A CAREFUL BALANCE BETWEEN INDIVIDUAL PRIVACY RIGHTS AND THE NEED FOR EFFECTIVE LAW ENFORCEMENT. THE ISSUE IS WHETHER THE STRINGENT RESTRICTIONS ON THE DISCLOSURE OF TAX DATA IN THE TAX REFORM ACT OF 1976 ARE STILL APPROPRIATE.

THE TAX REFORM ACT OF 1976 PLACED LIMITS ON IRS DISCLOSURE OF INFORMATION PROVIDED BY AMERICAN TAXPAYERS. THE ACT WAS PROMPTED BY THE WHOLESALE ABUSE OF TAX INFORMATION BY THE NIXON ADMINISTRATION. PRIOR TO 1976, THE IRS OPERATED LIKE A LENDING LIBRARY. NO STANDARDS WERE APPLIED BY WHICH TO JUDGE THE MANY REQUESTS FOR INFORMATION SUBMITTED BY OTHER GOVERNMENT AGENCIES. THE TAX REFORM ACT OF 1976 SUBSEQUENTLY ESTABLISHED SAFEGUARDS TO PROTECT THE PRIVACY OF INDIVIDUAL TAXPAYERS.

I CLEARLY RECOGNIZE THE NEED TO STRENGTHEN OUR NATION'S LAW ENFORCEMENT ACTIVITIES. TO WHAT EXTENT THE IRS SHOULD ASSUME A ROLE IN LAW ENFORCEMENT ACTIVITIES IS THE KEY SUBJECT OF TODAY'S HEARING.

I, FOR ONE, AM DEEPLY TROUBLED ABOUT INCREASING FEDERAL INTERFERENCE IN THE LIVES OF PRIVATE AMERICAN CITIZENS. THE IRS HAS VERY BROAD POWERS TO COMPEL THE PRODUCTION OF INFORMATION, AND I DON'T BELIEVE THE AMERICAN PEOPLE WANT THE IRS TO BE A GENERAL POLICE AGENCY. AMERICANS HAVE VOICED TIME AND AGAIN THEIR FRUSTRATION WITH UNDUE GOVERNMENT INTRUSION INTO THEIR LIVES.

IN THAT REGARD, MY PRINCIPAL CONCERNS WITH THE LEGISLATION BEFORE US TODAY ARE TWO-FOLD. FIRST, I AM CONCERNED ABOUT PROTECTING OUR SYSTEM OF VOLUNTARY COMPLIANCE WITH OUR TAX LAWS. THAT SYSTEM, AS MANY OF US KNOW, IS UNDER SEVERE STRAIN TODAY. SECOND, I AM CONCERNED ABOUT PROTECTING AMERICAN TAXPAYERS FROM UNWARRANTED INVASIONS BY THE GOVERNMENT.

NEVERTHELESS, DESPITE MY RESERVATIONS, MY MIND IS NOT CLOSED ON THE TAX DISCLOSURE ISSUE. I BELIEVE THAT SENATOR NUNN HAS IDENTIFIED SEVERAL CHANGES WHICH ARE CONSTRUCTIVE AND WOULD SERVE TO STRENGTHEN CRIMINAL LAW ENFORCEMENT.

I, THEREFORE, LOOK FORWARD TO TODAY'S HEARING.

Senator **Grassley**. Thank you very much.

Commissioner Egger, would you proceed?

STATEMENT OF HON. ROSCOE L. EGGER, JR., COMMISSIONER OF INTERNAL REVENUE, ACCOMPANIED BY DAVID G. GLICKMAN, DEPUTY ASSISTANT SECRETARY FOR TAX POLICY, DEPARTMENT OF THE TREASURY

Commissioner **Egger**. Thank you, Mr. Chairman.

I want to say at the outset that some of the comments which I will make will go to what is referred to as the administration bill, which is a bill assembled by the Justice Department with the assistance of other agencies, and which is in the process of being introduced. It tracks generally the concepts in S. 732.

Mr. Chairman, and members of the subcommittee, we are pleased to appear before you today to discuss the administration's proposals to amend the disclosure and third party summons provisions of the Internal Revenue Code. Accompanying us is David Dickinson of the Internal Revenue Service Office of Chief Counsel.

As you know, ours is a self-assessment tax system that depends substantially on voluntary compliance by taxpayers. The Secretary of the Treasury has broad authority to require all taxpayers to file tax returns and keep records necessary to a determination of their tax liability. In addition, the Secretary is authorized to examine books, papers, records or other data relevant or material to the determination of tax liability.

These powers are essential to enable the Internal Revenue Service to obtain by administrative action information necessary for tax administration. The scope and complexity of the tax laws require the Service to make a broad range of inquiries of taxpayers, both on the returns they file and during examinations and investigations.

Last year, we received more than 143 million returns from taxpayers and conducted more than 2.1 million examinations. We also initiated something more than 7,100 criminal investigations. As a consequence, the Service probably has more information concerning the lives and affairs of individuals and others than any other agency of the Federal Government.

The needs of nontax law enforcement and those of tax administration are in some respects difficult to reconcile. The balancing of these considerations is a delicate process. We acknowledge that it is difficult to strike a precise balance between the competing policy considerations, but believe the balance struck by the administration's bill is appropriate.

Perhaps the most fundamental change which the administration's bill would make is to distinguish between the books and records of individuals, on the one hand, and those of entities such as corporations, partnerships, and the like, on the other.

Access to Service information obtained from an individual's books and records for nontax related criminal purposes would continue to require a court order in most cases, whereas information from corporate books and records could be obtained by the Department of Justice upon request, or furnished to the Department by the Service on its own initiative under limited circumstances where evidence of nontax crimes was present.

We agree with this distinction. Individuals are entitled to a high degree of privacy protection with respect to records which they are required to maintain to meet their tax obligations. Corporations, on the other hand, generally may not have privacy interests of equal importance.

Furthermore, the administration bill has the effect of decentralizing from the Washington offices of the Department of Justice to responsible law enforcement officials in the field the authority to request information, thus significantly improving the timeliness and responsiveness of such requests.

Another significant improvement proposed by the administration bill is to correct a problem in the existing statute which could be interpreted to require law enforcement officials to know in advance the content of taxpayer return information before making a request for disclosure.

Further, the administration's bill clarifies section 7602 to enhance the Service's ability to use administrative summons and to access by the Service to grand jury information under rule 6(e) of the Federal Rules of Criminal Procedures for tax administration purposes.

We believe that the Administration's bill would also significantly improve the summons provisions of the Code by requiring taxpayers who oppose process against third party recordkeepers to contest those summons in courts. This change will alleviate unwarranted delays in tax examinations and investigations. The administration's bill would thus reduce a substantial burden on Government with no impact on legitimate taxpayer interests.

Section 6103 permits disclosures of tax information for Federal nontax criminal law enforcement purposes, subject to certain safeguards, but generally does not permit such disclosures for Federal nontax civil enforcement purposes, and permits no disclosures for State nontax criminal or civil enforcement purposes.

With respect to disclosures for nontax criminal law enforcement, section 6103 creates a distinction between returns filed by taxpayers and information furnished to the Service by the taxpayer or his representative, on the one hand, and information from sources other than the taxpayer, on the other.

In the case of returns and taxpayer return information, the Department of Justice and other Federal agencies must obtain a court order to obtain this information for nontax criminal law enforcement purposes. To obtain the order the Department or other Federal agency must show that there is reason to believe that a specific criminal act has been committed, that there is reason to believe that the information sought is probative evidence of a matter in issue, and that the information sought cannot be reasonably obtained elsewhere unless such tax information constitutes the most probative evidence.

In the case of information obtained by the Service from third parties, disclosure is permitted to the head of the Federal agency, or the Attorney General, the Deputy Attorney General, or an Assistant Attorney General in response to a written request setting forth certain specific information, including the specific reasons why the disclosure is or may be material to the nontax criminal proceeding or investigation.

In addition, the Secretary is authorized to volunteer third party evidence of a possible violation of a Federal criminal law to the head of the agency charged with enforcing that law.

As noted, the administration's bill would revise the distinction of current law with respect to disclosures of tax information for nontax law enforcement purposes. In all cases, access to the tax return itself would continue to require a court order. Maintenance of this privacy protection with respect to tax returns is, of course, essential to avoid jeopardizing our self-assessment tax system, a primary concern which led the Congress to revise section 6103 in 1976.

In the case of information obtained by the Service from an individual taxpayer which does not appear on his return, such as information from his books and records obtained in the course of a tax audit, the court order requirement is also retained. Once again, this protection is essential to maintenance of our present tax system.

There would be one exception to this rule, however, regarding an individual taxpayer's return and his books and records. If the Service referred the case to the Department of Justice with a recommendation for criminal prosecution, then the taxpayer's return and everything else in his file could be made available for nontax criminal law enforcement purposes.

With respect to corporate books and records, and those of other entities such as partnerships and trusts, information obtained by the Service from these sources would be available to the Department of Justice upon written request for non-tax criminal purposes.

Also, where the Service uncovered evidence of nontax crimes in the books and records of these entities, we would be obligated to furnish such evidence to the Department of Justice, but only if it were first determined that the entity was formed or is operated or maintained for a criminal purpose.

Return and return information disclosed to the Department of Justice pursuant to the revised disclosure provisions could be used by the Department for law enforcement purposes and, if a further court order were obtained, could be disclosed to State and local law enforcement officials.

We believe that these changes to the present disclosure rules would enhance Federal and State law enforcement efforts, while at the same time protecting essential taxpayer privacy necessary for the protection of our tax system. Admittedly, the balance is not easy to strike, but we feel that these changes to existing law would, in many instances, remove impediments to law enforcement efforts.

The Service has taken many steps to implement the present disclosure statute. Procedures covering disclosure for non-tax criminal prosecution or investigation were coordinated with the Criminal Division of the Department of Justice, and the Service assisted in the preparation of a manual for U.S. Attorneys for their guidance in obtaining returns and return information. We have trained our employees and created Disclosure Officer positions in each District, Region, and Service Center to administer disclosure activities.

We have also undertaken numerous administrative changes which have streamlined the disclosure process. In particular, we have decentralized the approval and processing procedures for disclosure in order to be more responsive to requests for return and return information. I have attached to my statement a summary listing of the actions the Service has taken to decentralize.

In addition to decentralizing, the Service has promoted the use of section 6103(i)(3) provisions for disclosing non-tax criminal violations. A series of memoranda to the field, as well as revised manual procedures, have been issued which explain and encourage the proper use of section 6103(i)(3).

This activity culminated in a January, 1981, memorandum to all Regional Commissioners requesting a response within 45 days to the Assistant Commissioner for Compliance outlining the the steps that have or will be taken to foster compliance with section 6103(i)(3). Analysis of the responses to this request identified additional matters which require clarification, and changes to our manual guidelines are currently being made.

We have also revised grand jury approval procedures to improve our capability for cooperation with other law enforcement agencies in joint criminal investigations. Timeframes have been established for each level of managerial approval of the request: Ten workdays for the Chief of the District's Criminal Investigation Division; 5 workdays for the District Director; 5 workdays for the Regional Commissioners; and 10 workdays for the Regional Counsel.

Approval authority for grand jury requests has been delegated to our Regional Commissioners, who may redelegate that authority to the Assistant Regional Commissioners for Criminal Investigation. These approvals must receive the concurrence of the Regional Counsel.

Expansions of existing grand jury authorizations now may be approved by District Directors with the concurrence of the Deputy Regional Counsel for Criminal Tax. Finally we are considering a further delegation of this authority to the District Directors.

Finally, I should like to comment on an important clarification and amendments which the administration's bill would make to sections 7609 and 7602.

Section 7609 requires the Service to provide the taxpayer with notice in connection with service of summons on certain specified "third party recordkeepers. Fo'llowing receipt of this notice, the taxpayer has 14 days to notify the summoned party not to comply with the summons and to furnish a copy of that notification to us. If the taxpayer requests the summoned party not to comply, the Service must then obtain a court order to obtain the summoned records.

At the time of its enactment, both the Service and the Department of Justice seriously questioned whether section 7609 should be enacted because they believed that the provision extended no additional substantive rights to taxpayers and offered opportunities to those who wished to delay or defeat tax investigations and examinations.

While acknowledging the validity of these arguments, Congress enacted section 7609 in the belief that the taxpayer himself would be more likely to assert whatever defenses to summons enforcement were available under existing law than would the third party recordkeeper.

Whatever procedural or substantive protections may be afforded taxpayers by the third party summons procedure, it is clear from the experience of the last 5 years that permitting taxpayers to stay compliance by simply sending a written notification to the summoned party imposes a substantial burden on the Federal Government that is not justified to protect the legitimate interests of taxpayers.

This has been abused and misused as a means of obstructing and delaying tax investigations. In fact, in numerous cases the delays have lasted for years, and when an enforcement action is commenced, many persons fail to assert their rights in court.

As a result, the stay of compliance procedure adopted in the Tax Reform Act of 1976 frequently serves not only to delay the tax investigation but also to waste the limited resources of the Service, the Department of Justice, and the courts.

The administration's bill would modify the stay of compliance procedure to place on the person entitled to notice the burden of commencing the summons litigation. Thus, any challenge by such a person to the summons would have to be made by filing a motion to quash in the U.S. District Court.

The motion to quash would have to be filed within 14 days, the same time limitation for such motions as is provided in the Right to Financial Privacy Act. This would enable courts to determine at the outset whether there was a legitimate issue or whether the purpose was merely to delay.

Section 7602, which authorizes the Service to examine books, records and other data, and to compel production of such information to determine liability for tax, would be amended in several respects.

First, section 7602 would be amended to permit the Service to issue an administrative summons for the sole purpose of conducting a criminal tax investigation. Under present law, the Service is prohibited from enforcing such a summons once it has determined to make a criminal tax referral to the Department of Justice. The present situation has permitted taxpayers to throw needless roadblocks in the way of proper criminal tax investigations.

Second, the administration's bill clarifies section 7602 to avoid situations which have occurred recently where our agents, working as agents of the Federal grand jury, have devoted enormous time to investigation of a taxpayer only to be deprived of the use of the information developed by the grand jury.

This problem arises as a result of several recent court decisions which denied the Service access to grand jury information for use in civil tax proceedings. The taxpayers involved generally are civilly liable, and the Service, upon entry of a court order under rule 6(e) of the Federal Rules of Criminal Procedure, should have access to information developed by the grand jury to assist in preparation for a civil tax proceeding.

In addition, grand juries frequently uncover evidence of bribes or other illegal forms of income that may not have been reported for tax purposes. In these situations, the Service has an obvious interest in assuring that appropriate taxes are paid on the illegal income. Thus, it would be proper for the Justice Department to seek release of grand jury information to the Service in such circumstances.

We believe that these proposed changes in sections 7609 and 7602 would significantly improve the Service's ability to effectively administer the Internal Revenue laws.

Mr. Chairman, this concludes our prepared statement. We would be glad to respond to any questions which you, or the members of the subcommittee, may have.

[Statement of Commissioner Egger follows:]

STATEMENTS OF ROSCOE L. EGGER, JR., COMMISSIONER OF INTERNAL REVENUE AND DAVID G. GLICKMAN, DEPUTY ASSISTANT SECRETARY FOR TAX POLICY

Mr. Chairman and Members of the Subcommittee: We are pleased to appear before you today to discuss the Administration's proposals to amend the disclosure and third party summons provisions of the Internal Revenue Code. Accompanying us is David E. Dickinson, of the Internal Revenue Office of Chief Counsel.

INTRODUCTION

As you know, ours is a self-assessment tax system that depends substantially on voluntary compliance by taxpayers. The Secretary of the Treasury has broad authority to require all taxpayers to file tax returns and keep records necessary to a determination of their tax liability.[1] In addition, the Secretary is authorized to examine books, papers, records, or other data relevant or material to the determination of tax liability.[2] These powers are essential to enable the Internal Revenue Service to obtain by administrative action information necessary for tax administration.

The scope and complexity of the tax laws require the Service to make a broad range of inquiries of taxpayers, both on the returns they file and during examination and investigations. Last year, we received more than 143 million returns from taxpayers, and conducted more than 2.1 million examinations. We also initiated something more than 7,100 criminal investigations. As a consequence, the Service probably has more information concerning the lives and affairs of individuals and others than any other agency of the Federal Government.

The needs of nontax law enforcement and those of tax administration are in some respects difficult to reconcile. The balancing of these considerations is a delicate process. We acknowledge that it is difficult to strike a precise balance between the competing policy considerations, but believe that the balance struck by the Administration's bill is appropriate.

Perhaps the most fundamental change which the Administration's bill would make is to distinguish between the books and records of individuals, on the one hand, and those of entities such as corporations, partnerships, and the like, on the other. Access to Service information obtained from an individual's books and records for nontax related criminal purposes would continue to require a court order in most cases, whereas information for corporate books and records could be obtained by the Department of Justice upon request or furnished to the Department by the Service on its own initiative under limited circumstances where evidence of nontax crimes was present. We agree with this distinction. Individuals are entitled to a high degree of privacy protection with respect to records which they are required to maintain to meet their tax obligations. Corporations, on the other hand, generally may not have privacy interests of equal importance.

Furthermore, the Administration bill has the effect of decentralizing from the Washington offices of the Department of Justice to responsible law enforcement officials in the field the authority to request information—thus significantly improving the timeliness and responsiveness of such requests.

Another significant improvement proposed by the Administration bill is to correct a problem in the existing statute which could be interpreted to require law enforcement officials to know in advance the contents of taxpayer return information before making a request for disclosure.

---

[1] Section 6001 of the Internal Revenue Code. (Unless otherwise specified, all references are to the Internal Revenue Code of 1954, as amended.)

[2] Section 7602.

Further, the Administration's bill clarifies section 7602 to enhance the Service's ability to use administrative summons and to access by the Service to grand jury information under Rule 6(e) of the Federal Rules of Criminal Procedure for tax administration purposes.

We believe that the Administration's bill would also significantly improve the summons provisions of the Code by requiring taxpayers who oppose process against third party recordkeepers to contest those summonses in courts. This change will alleviate unwarranted delays in tax examinations and investigations. The Administration's bill would thus reduce a substantial burden on Government with no impact on legitimate taxpayer interests.

CURRENT LAW

Section 6103 permits disclosures of tax information for Federal non-tax criminal law enforcement purposes, subject to certain safeguards, but generally does not permit such disclosures for Federal nontax civil enforcement purposes, and permits no disclosures for State nontax criminal or civil enforcement purposes.

With respect to disclosures for nontax criminal law enforcement, section 6103 creates a distinction between returns filed by taxpayers ("returns") and information furnished to the Service by the taxpayer or his representative ("taxpayer return information"), on the one hand, and information from sources other than the taxpayer ("return information") on the other. In the case of returns and taxpayer return information, the Department of Justice and other Federal agencies must obtain a court order to obtain this information for nontax criminal law enforcement purposes. To obtain the order, the Department or other Federal agency must show that there is reason to believe that a specific criminal act has been committed, that there is reason to believe that the information sought is probative evidence of a matter in issue, and that the information sought cannot be reasonably obtained elsewhere unless such tax information constitutes the most probative evidence.

In the case of information obtained by the Service from third parties, disclosure is permitted to the head of a Federal agency, or to the Attorney General, the Deputy Attorney General, or an Assistant Attorney General in response to a written request setting forth certain specific information, including the specific reasons why the disclosure is or may be material to the nontax criminal proceeding or investigation. In addition, the Secretary is authorized to volunteer third party evidence of a possible violation of a Federal criminal law to the head of the agency charged with enforcing that law.

SUGGESTED REVISIONS TO CURRENT LAW

As noted, the Administration's bill would revise the distinctions of current law with respect to disclosures of tax information for nontax law enforcement purposes. In all cases, access to the tax return itself would continue to require a court order. Maintenance of this privacy protection with respect to tax returns is, of course, essential to avoid jeopardizing our self-assessment tax system, a primary concern which led Congress to revise section 6103 in 1976.

In the case of information obtained by the Service from an individual taxpayer which does not appear on his return, such as information from his books and records obtained in the course of a tax audit, the court order requirement is also retained. Once again, this protection is essential to maintenance of our present tax system.

There would be one exception to this rule, however, regarding an individual taxpayer's return and his books and records. If the Service referred a case to the Department of Justice with a recommendation for criminal prosecution, then the taxpayer's return and everything else in his file could be made available for nontax criminal law enforcement purposes.

With respect to corporate books and records, and those of other entities such as partnerships and trusts, information obtained by the Service from these sources would be available to the Department of Justice upon written request for nontax criminal purposes. Also, where the Service uncovered evidence of nontax crimes in the books and records of these entities, we would be obligated to furnish such evidence to the Department of Justice, but only if it were first determined that the entity was formed, or is operated or maintained for a criminal purpose.

Returns and return information disclosed to the Department of Justice pursuant to the revised disclosure provisions could be used by the Department for law enforcement purposes and, if a further court order were obtained, could be disclosed to State and local law enforcement officials.

We believe that these changes to the present disclosure rules would enhance Federal and State law enforcement efforts while at the same time protecting essential taxpayer privacy necessary to protection of our tax system. Admittedly, the balance is not easy to strike, but we feel that these changes to existing law would, in many instances, remove impediments to law enforcement efforts.

SERVICE IMPLEMENTATION OF CURRENT LAW

The Service has taken many steps to implement the present disclosure statute. Procedures covering disclosures for nontax criminal prosecution or investigation were coordinated with the Criminal Division of the Department of Justice, and the Service assisted in the preparation of a manual for U.S. attorneys for their guidance in obtaining returns and return information. We have trained our employees and created Disclosure Officer positions in each District, Region, and Service Center to administer disclosure activities.

We have also undertaken numerous administrative changes which have streamlined the disclosure process. In particular, we have decentralized the approval and processing procedures for disclosure in order to be more responsive to requests for returns and return information. I have attached to my statement a summary listing the actions the Service has taken to decentralize.

In addition to decentralizing, the Service has promoted the use of section 6103 (i)(3) provisions for disclosing nontax criminal violations. A series of memoranda to the field, as well as revised manual procedures, have been issued which explain and encourage the proper use of section 6103 (i)(3). This activity culminated in a January, 1981 memorandum to all Regional Commissioners requesting a response within 45 days to the Assistant Commissioner (Compliance) outlining the steps that "have or will be taken to foster compliance with section 6103 (I)(3)." Analysis of the responses to this request identified additional matters which required clarification, and changes to our manual guidelines are currently being made.

We have also revised grand jury approval procedures to improve our capability for cooperation with other law enforcement agencies in joint criminal investigations. Time frames have been established for each level of managerial aproval of the request—ten workdays for the Chief of the District's Criminal Investigation Division, five workdays for the District Director, five workdays for the Regional Commissioner, and ten workdays for the Regional Counsel. Approval authority for Grand jury requests has been delegated to our Regional Commissioners, who may delegate that authority to the Assistant Regional Commissioners (Criminal Investigation). These approvals must receive the concurrence of the Regional Counsel. Expansions of existing grand jury authorizations now may be approved by District Directors with the concurrence of the Deputy Regional Counsel (Criminal Tax). Finally we are considering a further delegation of this authority to District Directors.

CLARIFICATION OF SECTIONS 7609 AND 7602

Finally, I should like to comment on important clarification and amendments which the Administration's bill would make to sections 7609 and 7602.

Section 7609 requries the Service to provide the taxpayer with notice in connection with service of summons on certain specified "third party recordkeepers." Following receipt of this notice, the taxpayer has 14 days to notify the summoned party not to comply with the summons and to furnish a copy of that notification to us. If the taxpayer requests the summoned party not to comply, the Service must then obtain a court order to obtain the summoned records.

At the time of its enactment, both the Service and the Department of Justice seriously questioned whether section 7609 should be enacted because they believed that the provision extended no additional substantive rights to taxpayers and offered opportunities to those who wished to delay or defeat tax investigations and examinations. While acknowledging the validity of these arguments, Congress enacted section 7609 in the belief that the taxpayer himself would be more likely to assert whatever defenses to summons enforcement were available under existing law than would the third party recordkeeper.

Whatever procedural or substantive protections may be afforded taxpayers by the third party summons procedures, it is clear from the experience of the last five years that permitting taxpayers to stay compliance by simply sending a written notification to the summoned party imposes a substantial burden on the Federal government that is not justified to protect the legitimate interests of taxpayers. This has been abused and misused as a means of obstructing and delaying tax investigations. In fact, in numerous cases the delays have lasted for years and when an enforcement action is commenced, many persons fail to assert their rights in court. As a result, the stay of compliance procedure adopted in the Tax Reform Act of 1976 frequently serves not only to delay the tax investigation but also to waste the limited resources of the Service, the Department of Justice, and the courts.

The Administration's bill would modify the stay of compliance procedure to place on the person entitled to notice the burden of commencing the summons litigation. Thus, any challenge by such a person to the summons would have to be made by filing a motion to quash in United States district court. The motion to quash would have to be filed within 14 days, the same time limitation for such motions as are provided in the Right to Financial Privacy Act. This would enable courts to determine at the outset whether there was a legitimate issue or whether the purpose was merely to delay.

Section 7602, which authorizes the Service to examine books, records, and other data, and to compel production of such information, to determine liability for tax, would be amended in several respects.

First, section 7602 would be amended to permit the Service to issue an administrative summons for the sole purpose of conducting a criminal tax investigation. Under present case law, the Service is prohibited from enforcing such a summons once it has determined to make a criminal tax referral to the Department of Justice. The present situation has permitted taxpayers to throw needless roadblocks in the way of proper criminal tax investigations.

Second, the Administration's bill clarifies section 7602 to avoid situations which have occurred recently where our agents, working as agents of a Federal grand jury, have devoted enormous time to investigation of a taxpayer only to be deprived of the use of the information developed by the grand jury. This problem arises as a result of several recent court decisions which denied the Service access to grand jury information for use in civil tax proceedings. The taxpayers involved generally are civilly liable, and the Service, upon entry of a court order under Rule 6(E) of the Federal Rules of Criminal Procedure, should have access to information developed by the grand jury to assist in preparation for a civil tax proceeding. In addition, grand juries frequently uncover evidence of bribes or other illegal forms of income that may not have been reported for tax purposes. In these situations, the Service has an obvious interest in assuring that appropriate taxes are paid on the illegal income. Thus, it would be proper for the Justice Department to seek release of grand jury information to the Service in such circumstances.

We believe that these proposed changes to sections 7609 and 7602 would significantly improve the Service's ability to effectively administer the internal revenue laws.

Mr. Chairman, this concludes our prepared statement. We shall be glad to respond to any questions which you and Members of your Subcommittee may have.

ACTIONS TAKEN IN DECENTRALIZATION OF IRO 6103(i)(1), (2) AND (3) DISCLOSURES

The following is a list of actions that have been taken to decentralize disclosures under IRC 6103(i)(1), (2) and (3):

1. REVISED DELEGATION ORDER

A Delegation Order was issued effective June 1, 1980, giving authority to District Directors and Assistant District Directors to make disclosure directly to the Department of Justice (DOJ) and the heads of Federal agencies under IRC 6103(i)(1) and (2). Authority was also delegated to Regional Commissioners to make disclosures of possible violations of Federal nontax criminal statutes under IRC 6103(i)(3). On May 26, 1981, District and Service Center Directors and their Assistants were delegated authority to make disclosures under IRC 6103(i)(3).

2. REVISED IRS MANUAL

Chapter (28)00 of Internal Revenue Manual 1272, Disclosure of Official Information Handbook, has been revised and issued to the field. Significant changes in this manual procedure are as follows:

a. IRS liaison districts were designated specific responsibility for coordinating with U.S. Attorneys and other DOJ agencies.

b. Specific time frames were established for completing processing for both routine and emergency requests. We have established the requirement that District, Regional, and National Office officials become personally involved when the request is not filled with the specified time frames.

c. A checklist was developed for use by District Disclosure personnel to insure through reviewing and processing of ex parte court orders and written requests without delay. In addition, a decision model chart was included in the chapter as a guide for processing.

d. Instructions were included in the text for processing special requests from DOJ.

e. Detailed instructions were provided for the processing of ex parte court orders under IRC 6103(i)(1) and written requests from heads of Federal agencies under IRC 6103(i)(2).

f. The District Director was identified as the IRS official with primary responsibility for liaison with U.S. attorneys.

g. New instructions were included to provide for the disclosure of evidence of violations of Federal nontax criminal laws.

h. Instructions concerning referrals to the Strike Force, DOJ, are changed to require that the Region, instead of the National Office, make such referrals.

3. TRAINING OF DISCLOSURE PERSONNEL

Regional Disclosure Officers received training in the new procedures by May 1980. They subsequently returned to their areas and conducted similar training for Disclosure Officers and Specialists from each district.

4. COORDINATION WITH DOJ

A meeting was held with the Acting Director, Office of Legal Support Services, DOJ and a representative of the Executive Office of United States Attorneys on April 23, 1980, and our decentralization plan was explained. Subsequently, we have held several meetings with officails in the Office of Legal Support Services and they have received training about our new procedures.

5. "HOT LINE" ESTABLISHED

A "hot line" has been established between Disclosure Operations Division and DOJ to handle problems arising during the first 2-3 weeks of our decentralization.

6. PRIORITY REQUESTS TO FRCS

The IRS Facilities Management Division, which is responsible for coordination with Federal Records Centers (FRCs), has agreed to identify IRC 6103(i)(1) and (i)(2) requests as priority to FRCs.

7. DEVELOPMENT OF VIDEO TRAINING TAPE

In participation with the Tax and Criminal Divisions, DOJ, we have developed a training video tape which is designed to stimulate more referrals to DOJ under IRC 6103(i)(3). This tape is currently being shown to IRS field personnel.

8. IRS-DOJ COORDINATING COMMITTEE

We have established an IRS-DOJ Coordinating Committee. The Directores, Disclosure Operations Division and Disclosure Litigation Division are designated as IRS representatives. The committee has met several times during the past months and will continue to exchange information and maintain a high level of cooperation between agencies.

9. BRIEFING U.S. ATTORNEYS

Each District Office made contact with their U.S. Attorney(s) office for the purpose of offering to brief them concerning the new procedures.

10. MONITORING IRS RESPONSE

During the balance of fiscal year 1980 we visitied IRS offices in three of seven Regions that receive the largest number of IRS 6103(i)(1) and (2) requests. The remaining four Regions were visited during the fiscal year 1981.

Senator **GRASSLEY**. I have questions, and I am sure Senator Baucus does, too.

Before I ask questions, I would like to ask the following people, who will be testifying, to limit their remarks to 5 minutes. I make this request at this point so that you will have an opportunity to summarize while you are sitting there.

Commissioner Egger, how much of a judgment call is involved in concluding that tax information constitutes evidence of a violation of Federal criminal law?

Commissioner EGGER. I am not sure. Service personnel by and large have very little training or experience in recognizing or evaluating evidence of the myriad of crimes for which title 18 of the United States Code imposes sanctions. It might be necessary to educate our employees on these matters.

Senator GRASSLEY. Do you have any problem with losing control over IRS information once you have released it to a Federal agency?

Commissioner EGGER. I don't have any real difficulty with that since we do release information to Federal agencies in a number of instances where the request is appropriate and where the information is needed. In every instance where that information is supplied, it is accompanied by a recitation of the obligations of that agency to protect that information.

Mr. Dickinson reminds me that in each instance, we are entitled to conduct safeguard examinations of those agencies. That is to say, if necessary we go to the agency and take a look at the procedures which they adopt and which they follow for the purpose of safeguarding the information.

Senator GRASSLEY. Under S. 732, the IRS will be required to release tax information which may constitute evidence of a violation of Federal criminal law. What standard will you use to determine that the information you have constitutes evidence of a crime?

Commissioner EGGER. It will have to be, again, a judgment call on the part of the investigating officers, and supervisors. They will have to simply apply their knowledge and their skills to analyzing the information, together with whatever other information has come into their possession in connection with the examination, and then make the best judgment call they can.

Senator GRASSLEY. Will the information assistance requirements of S. 732 cause any increase in IRS administrative costs?

Commissioner EGGER. Let me be sure that I am responding to your question. This is the one where we are required to make an affirmative judgment.

Senator GRASSLEY. Yes.

Commissioner EGGER. Yes; I think so. Whenever we are required to disclose more tax information for nontax purposes, and particularly where we must carefully examine the information as would be the case where nontax criminal offenses might be involved, our administrative costs will increase. However, one part of this bill is the amendment, which I referred to last in my comments the changes proposed to sections 7609 and 7602, and we believe that the savings in resources in those two instances will probably more than offset the additional expenditures.

Senator GRASSLEY. Either you or Mr. Glickman, do you have any revenue estimates for S. 732?

Commissioner EGGER. I don't have any revenue estimates. Pretty clearly, the ability of the IRS to work more closely, and to work on a more practical basis with agents of other investigative agencies should enhance the revenues, but we have no way of knowing what that would amount to.

Senator GRASSLEY. Mr. Glickman.

Mr. GLICKMAN. Mr. Chairman, I will check to see whether we have any. I do not have any with me. It may be very difficult to obtain an exact revenue estimate for something like that, but I will check and see what we can get for this committee.

Senator GRASSLEY. Commissioner Egger, will it be possible for the IRS to discern, which of their 143 million pieces of information, that an individual is about, for example, to destroy property or injure another person, or flee prosecution?

Commissioner EGGER. I doubt it since evidence of these potential crimes rarely appears on the face of the return.

Senator GRASSLEY. You doubt it.

If there is some, will the IRS report that tendency to the appropriate Federal agency?

Commissioner EGGER. Yes.

My first answer went to the question of whether or not we would be able to tell, from all of the 143 million returns. Obviously we don't look that closely at every one of those returns. There may be some in there that we would never see.

Senator GRASSLEY. Can you administer this affirmative duty of the emergency provisions?

Commissioner EGGER. To the extent that it is interpreted as requiring that we turn over information that comes to our attention in the course of conducting examinations, and so on, yes, that should not be a problem. The difficulty would arise if we were required to do special or additional investigations, that would take resources which we might not have.

Senator GRASSLEY. One of the criticisms of current policy is that all applications for information must be routed through Washington for approval before presentation to a court. Is it possible that regional permission could be granted or district?

Commissioner EGGER. Yes, I believe I made comments to that effect in my testimony.

Senator GRASSLEY. So that is one of the changes in policy?

Commissioner EGGER. Yes, and we are looking at further decentralization.

Senator GRASSLEY. You have instituted decentralization, or are you looking at decentralization?

Commissioner EGGER. Both. We have decentralized and are looking at further decentralization.

Senator GRASSLEY. Senator Baucus.

Senator BAUCUS. Thank you, Mr. Chairman.

Perhaps I missed it in your testimony, Commissioner, to what degree does the Service want to have the mandatory duty imposed upon it to turn over possible evidence of possible criminal conduct to the appropriate Federal agency?

Commissioner EGGER. I doubt if it really makes any difference to us, Senator Baucus. I can't imagine a circumstance in which we would come across evidence of a serious crime that we would not want to turn over, unless it were a violation of IRC Section 6103.

Senator **Baucus**. Under present law, the Service may, at its own discretion, turn over evidence of a crime.

Commissioner **Egger**. Only in certain circumstances involving evidence obtained from third parties.

Senator **Baucus**. What about evidence that is not third party evidence, but evidence that is obtained from the taxpayer directly or from the return?

Commissioner **Egger**. If it comes to us in that fashion, we cannot volunteer it.

Senator **Baucus**. Even if it is an obvious commission of a crime?

Commissioner **Egger**. In an extreme case, obviously, we would try to find a way to do it.

Senator **Baucus**. But if it is not an extreme case, but an obvious case.

Commissioner **Egger**. If it were an obvious case, and so on, we are practical people and I think we would try to find some way to make sure that that information came into the hands of the proper agency, if it were truly obvious that a serious crime had or was about to be committed.

Senator **Baucus**. So I am asking, as a practical matter, how much more information under the Nunn bill, would Service disclose affirmatively to the Federal agencies, compared with the amount of information that the Service now turns over to the appropriate Federal agencies?

Commissioner **Egger**. I can't say how much more. But pretty clearly the Department could make written requests for information under S. 732 fairly readily, which right now they have to have a court order to obtain.

Senator **Baucus**. What do you understand to be the big problem that Federal law enforcement agencies have in getting appropriate IRS information; is it the standard for getting the information from the taxpayer's return, or the taxpayer return information that is the biggest problem, or is it the administrative delays that are the problem, or is it the third party information?

What is the practical matter from the law enforcement officer point of view?

Commissioner **Egger**. It is really timing as much as anything, Senator Baucus. What frequently happens is that our agents, working jointly with agents of another agency, let's say Drug Enforcement or something of that sort, develop information in the course of the investigation, and we cannot just immediately turn that over. A fairly lengthy procedure must be followed in order to do that. Very frequently the information is valuable only if it can be furnished quickly, you see. That is a very large part of it.

Senator **Baucus**. I will ask again. Is the timeliness problem a problem of standards that must be met? Or is the timeliness problem a problem of administrative redtape, and bureaucratic delay?

Commissioner **Egger**. To the extent that the problem results from redtape, we are doing everything we can to reduce that. The present statutory standards do proscribe the disclosure of certain information.

Senator **Baucus**. Let me ask my question again. I understand you are doing all this, and your answer is really a repetition of my question.

The question is, To what degree is it one or the other?

Commissioner **Egger**. I just don't know. I am not sure that I can answer that.

Mr. **Dickinson**. Senator Baucus, is that the Internal Revenue Service is able to decentralize by adminstrative action, and we have done that. The difficulty is that the Department of Justice cannot decentralize because the statute requires approval at very high levels here in Washington and S. 732 would permit approval at much lower levels.

Senator **Baucus**. You are suggesting that the problem is not the standard, but the problem is excessive centralization at the Department of Justice.

Mr. **Dickinson**. I understand that it may be a combination of the two. The relevancy standards of section 6103(i)——

Senator **Baucus**. Do you know the degree to which this problem is excessive centralization, on the one hand, or is the impossibly high standard to meet, on the other?

Mr. **Dickinson**. No, I do not.

Senator **Baucus**. Let me ask you the same kind of question in a different area. To what degree is the problem the unavailability of probative evidence sought by the Federal law enforcement agency directly from IRS, on the one hand, compared with the situation where the Federal law enforcement agency is trying to get third-party information?

You may not be in a position to answer that. But if you do have a good feel for that, I would appreciate your answer. If you can't, we will ask somebody else to answer that.

Commissioner **Egger**. Let us inquire of our associates, and if we can, we will supply that information for the record.

Mr. **Dickinson**. This information should be available from the Justice Department.

Senator **Baucus**. The obvious point there, I am concerned that the bill, Senator Nunn's bill, might be a sledge hammer to kill a fly. In the meantime, the sledge hammer is going to possibly catch a lot of innocent people, and cause a lot of excessive problems.

I am trying to find the right scalpel, rather than the ax, to try to solve the problem, so we can catch these drug offenders and the criminals.

Thank you very much.

Senator **Grassley**. Thank you very much, Commissioner Egger and your staff.

It is now my pleasure to call to the witness table the Deputy Attorney General, Edward C. Schmults. You may proceed with your testimony, and if you want the entire statement to be printed in the record, it will be.

STATEMENT OF EDWARD C. SCHMULTS, DEPUTY ATTORNEY GENERAL, DEPARTMENT OF JUSTICE

Mr. **Schmults**. Thank you very much, Mr. Chairman.

I would like the entire statement printed in the record. I have attempted in the past few minutes to shorten it substantially, so there will be parts of it to which I will not refer.

It is a pleasure to have the opportunity to testify today on behalf of the Department of Justice regarding disclosure of tax information for use in nontax criminal cases. As you know, the administration today is submitting its own series of proposed tax disclosure amendments for consideration by the Congress.

Generally, the amendments that we propose parallel those in S. 732, which was approved by the Senate as an amendment to the Economic Recovery Tax Act of 1981, and are consistent with the recommendations of the Attorney General's Task Force on Violent Crime, cochaired by Judge Griffin Bell and Gov. James Thompson of Illinois.

Our proposal is broader than S. 732, however, in that it also addresses needed changes in the methods by which the Internal Revenue Service obtains information for use in connection with investigation of tax crimes. We believe that both of these access-to-information issues arising under the Tax Reform Act of 1976 should be treated together.

In connection with any consideration of law enforcement access to information, I believe there are two points which must be kept in mind.

First, law enforcement agencies are primarily information collecting and processing entities. When a crime is committed, the task falls to law enforcement officials to gather and assemble the facts necessary to establish the various elements of the offense. The information so collected is ultimately presented to courts of law so that justice can be administered. Because the Government, in a criminal trial, has the burden of proving every element of the offense beyond a reasonable doubt, the need for access to information is even more important than in normal civil proceedings.

Courts are keenly aware of the importance of information to the administration of justice, and have avoided creation of restraints upon access to information. Evidentiary privileges established at common law, for example, have not been significantly expanded over the past century.

The Supreme Court has often stated, both in civil and criminal cases, that restraints upon access to information are not lightly created nor expansively construed as they impede the search for truth that is at the heart of every judicial proceeding.

Our adversary criminal justice system requires that law enforcement agencies have reasonable access to information if they are to fulfill their responsibilities to the public.

The second point I would make, preliminary to any discussion of restrictions upon law enforcement access to information, is that Federal law enforcement agencies rely much more heavily upon documents than ever before in our history. This is a result of the types of criminal cases now receiving priority attention for Federal investigation and prosecution.

As the Attorney General has stated, narcotics trafficking, organized crime, public corruption, fraud against the Government, and white-collar crime are foremost targets of the Department of Justice's investigative and prosecutorial endeavors.

The investigation and prosecution of such sophisticated criminal offenses require more frequent resort to documentary information—and particulary financial data—than to street crimes, which often can be proved purely on the basis of eyewitness testimony. While formerly law enforcement officials only occasionally relied on documentary records, a Federal case today is seldom developed without access to documents.

The problems posed by enactment of the tax disclosure restrictions of 1976 have been well documented in hearings during the 96th Congress before several congressional committees, most notably the Senate Permanent Subcommittee on Investigations and this subcommittee.

While some of the more shocking findings made during those hearings have been mitigated as a result of adminstrative steps taken by the Internal Revenue Service and the Department of Justice, legislative reform remains urgent.

In summary, at a time when Federal investigative and prosecutorial efforts are increasingly directed toward sophisticated nontax crimes in which tax information is frequently needed, law enforcement access to such information has been precipitously curtailed.

In 1975, before tax disclosure restrictions were enacted, Federal investigators and prosecutors sought tax information on approximately 1,800 occasions. In fiscal year 1980, that figure had plummeted to 255, or about 14 percent of the 1975 level.

Even after significant efforts by the Department of Justice to increase use of tax information in appropriate cases, the request figure of fiscal year 1981 was only 350. As surveys of Federal prosecutors have shown, this decline is attributable in principal part to the complexity of tax disclosure procedures.

Turning to the specific reforms we suggest, let me proceed through the legislative proposal submitted by the administration, highlighting the most significant provisions and noting variations between the administration bill and S. 732 which is pending before the subcommittee.

The fundamental safeguards of taxpayer privacy enacted in 1976 are preserved in the administration bill. The effort throughout both proposals, that is the administration bill and S. 732, is to eliminate counterproductive procedures and to conform the language of the statute to actual practice.

Both proposals seek to simplify the definitions applicable to request for information needed in connection with nontax cases. In place of the series of four confusing definitions in existing law, both bills use two new definitions which conform to the two procedures by which the information is obtained.

The first category of information, return information, consists of all returns and accompanying schedules together with all information furnished by an individual taxpayer such as during an IRS tax audit. As under existing law, this return information could be disclosed only pursuant to court order, based upon a showing of objective reasonableness.

The second category of information, nonreturn information, consists of information obtained from sources other than an individual taxpayer, or in the case of legal entities, from information furnished by the legal entity, other than the information supplied on the tax return itself. This nonreturn information may be disclosed pursuant to formal request, a written request that is, by designated Federal law enforcement officials or, in the case of an entity formed or being operated with the purpose to violate Federal criminal law, pursuant to an IRS initiated report of nontax crime.

Both S. 732 and the administration's bill seek to streamline procedures by which Federal prosecutors obtain court orders for disclosure of return information. Improvements include the elimination of the requirement that officials in Washington authorize any application to a court for a disclosure order. This will reduce needless delay.

Both bills authorize U.S. magistrates, in addition to district judges, to decide applications or issue disclosure orders. Magistrates are currently empowered to issue analogous orders such as search warrants.

Both proposals also modify the requirements for court orders to make statutory standards comply with actual judicial practice. This will avoid prospects for inconsistent judicial results and the chilling effects of the rigorous statutory language but will have no adverse impact upon privacy interests as it merely represents a codification of existing practice in our view.

The administration's proposal departs from S. 732 in two respects with regard to court orders. First, our bill makes it clear that a court order authorizes disclosure of both return and nonreturn information. In other words, if a prosecutor is able to make the showing required to secure the more stringently protected tax information, he should, without the necessity of filing a separate written request, be able to secure related nonreturn information.

Second, our bill expressly authorizes entry of a disclosure order upon a showing of reasonable cause to believe that tax information may be relevant to locating a person who is a fugitive from justice and for whom a judicial arrest warrant has been issued. Tax information often provides valuable leads that assist in determining the whereabouts of fugitives.

Both bills also seek to simplify the procedure by which law enforcement officials request nonreturn information. Rather than requiring an official in Washington to file a request, the amendments to section 6103(i)(2) would permit Federal prosecutors in the field to file written requests. As in the court order area, the standards for such a request are modified to conform the language of the statute to present practice.

The one difference between S. 732 and the administration's bill in this area is that S. 732 would authorize investigative agents in the field to file (i)(2) requests, whereas under the administration's bill, only the head of an investigative agency, for example, the Director of the FBI or the U.S. Secret Service, could request (i)(2) information; otherwise request would be filed by supervisory-level Federal prosecutors.

Both bills would seek to encourage IRS reports of nontax crime by making such referrals mandatory rather than discretionary. Moreover, both would increase the number of such reports by providing that the referral of a taxpayer's file to the Department of Justice for criminal tax prosecution may be accompanied by referral of any information evidencing nontax crime.

Those who violate our tax laws should not benefit from restrictions enacted to protect those who honestly report their incomes. The administration bill, however, would prohibit the Secretary from reporting nontax offenses based upon information provided by or on behalf of legal entities except where the Secretary has reasonable cause to believe the legal entity was formed or is being operated or maintained with a purpose to facilitate or engage in Federal criminal activities.

Thus, if the IRS, in the process of auditing a sham corporation or business being used to facilitate narcotics trafficking or organized crime, uncovers evidence of nontax crime in the business' books and records, that information would be reported to the Department of Justice. To the extent of an IRS audit of a legitimate business or other legal entity, the rule applicable to individuals would apply, no disclosure except as initiated by Federal law enforcement agencies.

Both bills also propose new subsections of 6103(i) to permit Federal prosecutors to redisclose tax information to State and local prosecutors in carefully circumscribed situations. Upon application by a Federal official and entry of a court order finding reasonable cause to believe the tax information is relevant to a State felony, the information would be disclosed to appropriate State or local prosecutor for use solely in the investigation or prosecution of the State felony offense.

I would like to underscore that that provision will be applicable only where the Federal prosecutor already has the tax information for use, presumably, in a Federal nontax crime, and then discovers it would be relevant to a State felony. In such a case, the Federal prosecutor would go to court and seek a court order permitting redisclosure. So this is not a gaping hole that would permit State and local prosecutors to get tax information willy-nilly. This is a very carefully circumscribed provision.

On foreign intelligence, the administration's bill, but not S. 732, would authorize disclosure of tax information for use in connection with foreign positive or counterintelligence investigations directed at specifically enumerated activities involving foreign powers. This procedure is similar to the analogous provision of the Financial Privacy Act, but is more carefully limited in that it requires a personal certification by the Attorney General. The disclosures sought pursuant to this provision would be reported regularly to the House and Senate Intelligence Committees.

In conclusion, we believe that the amendments the administration is proposing leave intact the basic privacy protections inscribed in 1976. It is crucial that the disclosure and access to the information provisions of the Tax Reform Act of 1976 reflect a judicious balance between the legitimate competing interests of taxpayer privacy and tax administration on the one hand, and the public interest in the proper administration of justice on the other.

The administration has concluded, based on experience of almost 5 years that the tax disclosure restrictions have been in force, that there exists a clear and compelling need for adjustment in the 1976 law. On behalf of the administration and of law enforcement officials, I urge your prompt and careful attention to the proposals we have submitted.

Thank you very much, Mr. Chairman.

[Statement of Mr. Schmults follows:]

STATEMENT

OF

EDWARD C. SCHMULTS
DEPUTY ATTORNEY GENERAL

BEFORE THE

SUBCOMMITTEE ON OVERSIGHT OF
THE INTERNAL REVENUE SERVICE
COMMITTEE ON FINANCE
UNITED STATES SENATE
WASHINGTON, D.C.

CONCERNING

DISCLOSURE OF TAX INFORMATION
FOR USE IN NONTAX CRIMINAL CASES

NOVEMBER 9, 1981

Mr. Chairman and Members of the Subcommittee:

It is a pleasure to have the opportunity to testify today on behalf of the Department of Justice regarding disclosure of tax information for use in nontax criminal cases. As you know, the Administration today is submitting its own series of proposed tax disclosure amendments for consideration by the Congress. Generally, the amendments we propose parallel those in S. 732 (which was approved by the Senate as an amendment to the Economic Recovery Tax Act of 1981) and are consistent with the recommendations of the Attorney General's Task Force on Violent Crime co-chaired by Judge Griffin Bell and Governor James Thompson. Our proposal is broader than S. 732, however, in that it also addresses needed changes in the methods by which the Internal Revenue Service obtains information for use in connection with investigation of tax crimes. We believe that both of these access-to-information issues arising under the Tax Reform Act of 1976 should be treated together.

TAX DISCLOSURE RESTRICTIONS IN PERSPECTIVE

In connection with any consideration of law enforcement access to information, I believe there are three points which must be kept in mind. First, law enforcement agencies are primarily information collecting and processing entities. When a crime is committed, the task falls to law enforcement officials to gather and assemble the facts necessary to establish the various elements of the offense. The information so collected is ultimately presented to courts of law so that justice can be administered. And because the government, in a criminal trial, has the burden of proving every element of the offense beyond a reasonable doubt, the need for access to information is even more important than in normal civil proceedings.

Courts are keenly aware of the importance of information to the administration of justice and have avoided creation of restraints upon access to information. Evidentiary privileges established at Common Law, for example, have not been significantly expanded over the past century. The Supreme Court has often stated in both civil and criminal cases[1] that restraints upon access to information are not lightly created nor expansively construed as they impede the search for truth that is at the heart of every judicial proceeding. Our adversary criminal justice system requires that law enforcement agencies have reasonable access to information if they are to fulfill their responsibilities to the public.

The second point which I would make preliminary to any discussion of restrictions upon law enforcement access to information is that federal law enforcement agencies rely much more heavily upon documents than ever before in our history. This is a result of the types of criminal cases now receiving priority attention for federal investigation and prosecution. As the Attorney General has stated, narcotics trafficking, organized crime, public corruption, fraud against the government and white-collar crime are foremost targets of the Department's investigative and prosecutorial endeavors. The investigation and prosecution of such sophisticated criminal offenses require more frequent resort to documentary information -- and particularly financial data -- than do street crimes which often can be proved purely on the basis of eyewitness testimony. While formerly law enforcement officials only occasionally relied on documentary records, a federal case today is seldom developed without access to documents.

---

[1] E.g., Herbert v. Lando, 441 U.S. 153, 175 (1979), United States v. Havens, 446 U.S. 620, 627-28 (1980).

Third and finally, I would note that, when we discuss restrictions upon law enforcement access to tax information, we must be mindful of the network of statutory restraints that currently obtain. The Privacy Act of 1974, 2/ for example, restricts access to information in systems of records held by other federal agencies. The Right To Financial Privacy Act of 1978 3/ restricts law enforcement access to information held by depository institutions and credit card issuers. The Fair Credit Reporting Act 4/ restricts law enforcement access to credit information held by credit reporting agencies.

Unfortunately, the various procedures and requirements with which law enforcement officials must comply in order to secure access to these various classes of documentary information are not uniform. As a result, criminal investigators and prosecutors must negotiate a labyrinth of varying procedural requirements in order to secure access to the different types of information needed to prosecute a complex criminal case. Although we do not suggest that this subcommittee should or can deal effectively

---

2/ Generally, information is available only pursuant to formal law enforcement request or court order, 5 U.S.C. 552a(b).

3/ Information is subject to an elaborate series of overlapping restraints which vary depending upon the form of process utilized,
12 U.S.C. 3401-3422.

4/ Credit reports are available for law enforcement purposes only pursuant to court order, 15 U.S.C. 1681(b)(1).

with this larger issue of uncoordinated restrictions upon law enforcement access to information, we do hope that you will keep its existence in mind when considering our proposals to alleviate what we believe to be the needlessly complex, cumbersome, and ambiguous provisions of the Tax Reform Act of 1976.

THE PROBLEM AND ITS MANIFESTATIONS

The problems posed by enactment of the tax disclosure restrictions of 1976 have been well documented in hearings during the 96th Congress before several Congressional Committees, most notably the Senate Permanent Subcommitee on Investigations and this Subcommittee. While some of the more shocking findings made during those hearings have been mitigated as the result of administrative steps taken by the Internal Revenue Service and the Department of Justice, legislative reform remains urgent.

In summary, at a time when federal investigative and prosecutive efforts are increasingly directed toward sophisticated nontax crimes in which tax information is frequently needed, law enforcement access to such information has been precipitously curtailed. In 1975, before tax disclosure restrictions were enacted, federal investigators and prosecutors sought tax information on approximately 1,800 occasions. In FY 1980, that figure had plummeted to 255 -- about 14% of the 1975 level. Even after significant efforts by the Department of Justice to increase use of tax information in appropriate cases, the request figure of FY 1981 was only 350. As surveys of federal prosecutors have shown, this decline is attributable in principal part to the complexity of tax disclosure procedures.

Moreover, the tax disclosure restrictions of 1976 obstruct effective cooperation between the Department of Justice and the Internal Revenue Service. For example, the number of Organized Crime Strike Force cases initiated by the Service was 620 in FY 1975; that number had fallen by almost two-thirds in FY 1978. In many cases IRS agents have uncovered evidence of serious nontax federal crimes unknown to federal law enforcement agencies and have reported these offenses to IRS headquarters. The reported crimes, however, go unpunished because of the disclosure restrictions of the 1976 law. Finally, although nontax crimes frequently involve tax violations as well -- tax compliance among criminals is notoriously low -- the Tax Reform Act of 1976 severely inhibits joint tax-nontax investigations resulting in duplication of investigative effort.

In summary, we believe that the 1976 tax disclosure restrictions have had a substantial adverse impact upon federal law enforcement efforts. In fact, as among the nineteen criminal justice legislative initiatives which the Administration has endorsed, we believe reform of tax disclosure laws is of paramount importance in constructing an effective assault on narcotics trafficking, organized crime and other offenses involving large sums of money.

HIGHLIGHTS OF PROPOSED DISCLOSURE AMENDMENTS

Turning to the specific reforms we suggest, let me proceed through the legislative proposal submitted by the Administration, highlighting the most significant provisions and noting variations between the Administration bill and S. 732 which is pending before the Subcommittee. At the outset, I believe both our bill and S. 732 are accurately characterized as proposals to "fine-tune" existing law. The fundamental safeguards of taxpayer privacy enacted in 1976 are preserved. The effort throughout both proposals is to eliminate counterproductive procedures and to conform the language of the statute to actual practice.

DEFINITIONS

[26 U.S.C. 6103(b)]

Both proposals seek to simplify the definitions applicable to requests for information needed in connection with nontax cases. In place of the series of four confusing definitions in existing law, both bills use two new definitions which conform to the two procedures by which information is obtained. The first category of information, "return information," consists of all returns and accompanying schedules together with all information furnished by an individual taxpayer as during an IRS tax audit. As under existing law, this "return information" could be disclosed only pursuant to court order based upon a showing of objective reasonableness. The second category of information -- "nonreturn information" -- consists of information obtained from sources other than an individual taxpayer, or, in the case of legal entities, from information furnished by the legal entity other than the information supplied on the tax return itself. This "nonreturn information" may be disclosed pursuant to formal written request by designated federal law enforcement officials or, in the case of an entity formed or being operated with a purpose to violate a federal criminal law, pursuant to an IRS-initiated report of nontax crime.

One difference between S. 732 and the Administration definitions is that S. 732 would change the definitions for all the various subsections of Section 6103. Because the thrust of these tax disclosure amendments is to facilitate appropriate law enforcement access to tax information, the Administration's bill is written in such a way as to limit the application of the new definitions to subsection 6103(i) governing access to tax information for nontax criminal cases. This avoids any unnecessary administrative burden upon the IRS and other agencies which use tax information pursuant to other subsection of 6103. In addition, S. 732 would require the IRS to disclose evidence of nontax crimes obtained, e.g., from an audit in the case of even a legitimate corporation or other entity -- an aspect which we believe is not essential for sound law enforcement and could have serious repercussions on the relationship of the IRS to legitimate business concerns.

COURT ORDER PROCEDURES

[26 U.S.C. 6103(i)]

Both S. 732 and the Administration bill seek to streamline procedures by which federal prosecutors obtain court orders for disclosure of "return information." Improvements include elimination of the requirement that officials in Washington authorize any application to a court for a disclosure order. This will reduce needless delay. Both bills authorize United States Magistrates, in addition to District Judges, to decide applications or issue disclosure orders. Magistrates are currently empowered to issue analogous orders such as search warrants. Both proposals also modify the requirements for court orders to make statutory standards comply with actual judicial practice. This will avoid prospects for inconsistent judicial results and the chilling effects of the rigorous statutory language but will have no adverse impact upon privacy interests as it is merely a codification of existing practice.

The Administration's proposal departs from S. 732 in two respects with regard to court orders. First, our bill makes clear that a court order authorizes disclosure of both "return" and "nonreturn" information. In other words, if a prosecutor is able to make the showing required to secure the more stringently protected tax information, he should --without the necessity of filing a separate written request -- be able to secure related nonreturn information. Second, our bill expressly authorizes entry of a disclosure order upon a showing of reasonable cause to believe that tax information may be relevant to locating a person who is a fugitive from justice and for whom a judicial arrest warrant has been issued. Tax information often provides valuable leads that assist in determining the whereabouts of fugitives.

FORMAL REQUEST PROCEDURE

[26 U.S.C. 6103(i)(2)]

Both bills also seek to simplify the procedure by which law enforcement officials request nonreturn information. Rather than requiring an official in Washington to file the request, the amendments to §6103(i)(2) would permit federal prosecutors in the field to file written requests. As in the court order area, the standards for such a request are modified to conform the language of the statute to present practice.

The one difference between S. 732 and the Administration bill in this area is that S. 732 would authorize investigative agents in the field to file (i)(2) requests. Under the Administration bill, only the head of an investigative agency (e.g., Director of the FBI or U.S. Secret Service) or Inspectors General could request (i)(2) information; otherwise, requests would be filed by supervisory-level federal prosecutors.

IRS-INITIATED REPORTS OF CRIME

[26 U.S.C. 6103(i)(3)

Both bills would seek to encourage IRS reports of nontax crime by making such referrals mandatory rather than discretionary. Moreover, both would increase the numbers of such reports by providing that referral of a taxpayer's file to the Department of Justice for criminal tax prosecution may be accompanied by referral of any information evidencing nontax crime. Those who violate our tax laws should not benefit from restrictions enacted to protect those who honestly report their incomes. The Administration bill, however, would prohibit the Secretary from reporting nontax offenses based upon information provided by or on behalf of legal entities except where the Secretary has reasonable cause to believe the legal entity was formed or is being operated or maintained with a purpose to facilitate or engage in federal criminal activities. Thus if the IRS, in the process of auditing a sham corporation or a business being used to facilitate narcotics trafficking or organized crime, uncovers evidence of nontax crime in the business's books and records, that information would be reported to the Department of Justice. To the extent of an IRS audit of a legitimate business or other legal entity, the rule applicable to individuals would apply -- no disclosure except as initiated by federal law enforcement agencies.

EMERGENCY DISCLOSURES

[26 U.S.C. 6103(i)(5)

The Right to Financial Privacy Act of 1978 recognizes that there will occasionally be situations in which disclosure of financial information is necessary on an expedited basis to avoid threats to life, serious property damage or flight from prosecution. This 1978 law contains a special emergency provision (12 U.S.C. 3414(a)). Both S. 732 and the Administration bill propose similar emergency disclosure provisions applicable to tax information.

DISCLOSURES TO STATE AND LOCAL PROSECUTORS

[26 U.S.C. 6103(i)(7)]

Both bills also propose new subsections of §6103(i) to permit federal prosecutors to redisclose tax information to State and local prosecutors in carefully circumscribed situations.

Upon application by a federal official and entry of a court order finding reasonable cause to believe the tax information is relevant to a State felony, the information would be disclosed to the appropriate State or local prosecutor for use solely in the investigation or prosecution of the State felony offense.

FOREIGN INTELLIGENCE ACCESS

[26 U.S.C. 6103(i)(9)]

The Administration bill, but not S. 732, would authorize disclosure of tax information for use in connection with foreign positive or counter-intelligence investigations directed at specifically enumerated activities involving foreign powers. This provision is similar to the analogous provision of the Financial Privacy Act (12 U.S.C. 3414(b)) but is more carefully limited in that it requires a personal certification by the Attorney General. The rare disclosures sought pursuant to this provision would be reported regularly to the House and Senate Intelligence Committees.

OTHER DISCLOSURE PROVISIONS

[26 U.S.C. 6103(i)(4), (6) and (8)]

Both bills would revise §6103(i)(4) to clarify that admission of tax information into evidence is governed by the Federal Rules of Evidence rather than special evidentiary rules applicable only to tax information. Both would also authorize disclosure of tax information to foreign governments pursuant to mutual assistance treaties or conventions. Such international exchanges of tax information are already authorized in connection with tax matters (§6103(k)(4)).

Both bills also seek to clarify that joint tax-nontax investigations are proper under the Internal Revenue Code.

SUMMONS AND SUMMONS ENFORCEMENT PROVISIONS

[26 U.S.C. 7602 and 7609]

In addition to disclosure amendments, the Administration bill seeks to facilitate IRS access to the information it needs in connection with a purely criminal tax investigation. In the summons enforcement area, we propose that the procedures of the Internal Revenue Code be revised to conform more closely to those of the Right to Financial Privacy Act of 1978.

The difficulties which the Service faces in these areas are enormous and can be substantially resolved without adversely affecting privacy interests. As the focus of this hearing is tax disclosure, I will not go into more detail with respect to the summons-related amendments except to repeat that it is the view of the Department of Justice and the Administration that tax disclosure and summons amendments should be considered together.

CONCLUSION

The foregoing remarks are merely the highlights of our proposals. The section-by-section summary accompanying the Administation proposal sets out our position in more detail. In addition, representatives of the Department are, of course, available to discuss our proposals and the need therefor at the convenience of the Members and staff of the Subcommittee.

We believe that the modest amendments we propose leave intact the basic privacy protections which the Congress inscribed in 1976. It is crucial that the disclosure and access to information provisions of the Tax Reform Act of 1976 reflect a judicious balance between the legitimate competing interests of taxpayer privacy and tax administration, on the one hand, and the public interest in the proper administration of justice on the other hand. This Administration has concluded, based upon experience during the almost five years that the tax disclosure restrictions have been in force, that there exists a clear and compelling need for adjustments in the 1976 law. On behalf of the Administration and of law enforcement officials, I urge your prompt and careful attention to the proposals we have submitted.

Thank you.

U.S. Department of Justice
Office of the Deputy Attorney General

The Deputy Attorney General
Washington, D.C. 20530

NOV 19 1981

The Honorable Charles E. Grassley
Chairman, Subcommittee on Oversight
of the Internal Revenue Service
Committee on Finance
United States Senate
Washington, D.C. 20510

Dear Mr. Chairman:

This is with reference to my testimony on Monday, November 9, regarding disclosure of tax information for use in nontax criminal cases. During the hearing, I offered to supplement the hearing record with respect to the number of occasions upon which applications for disclosure orders under 6103(i)(1) of the Internal Revenue Code have been denied.

Because statistics maintained by the Department of Justice do not record information on (i)(1) applications and the disposition thereof, I am unable to provide a definitive answer to the question. Attorneys in the Criminal Division of the Department, however, indicate that they are aware of three instances in which (i)(1) applications were rejected. The first involved a federal investigation into international narcotics trafficking and resulted in a published opinion, United States v. Praetorius, 451 F. Supp. 371 (E.D.N.Y. 1978). The second denial of which we are aware occurred in October of this year and involved a federal investigation into mail fraud and perjury. The third denial occurred this month and involved an investigation of a large-scale fraud-by-wire scheme. Because these two applications relate to ongoing criminal cases, it would be inappropriate for me to furnish additional information in this public report.

In submitting this information, I should once again clarify that it is not merely the potential for denial of applications which discourages federal prosecutors from seeking tax information. Rather, the cumbersome procedures, delay, paperwork and unrealistic statutory standards combine to deter federal prosecutors from seeking tax information. As a 1980 survey conducted by the Tax Division noted, approximately half of all federal prosecutors surveyed indicated that they had sought tax information on only one or two occasions since the Tax Reform Act of 1976 became effective because of the cumbersome procedures and delay involved. The potential that a federal judge will interpret disclosure restrictions in a hypertechnical way is merely one additional consideration which discourages prosecutors from seeking tax information in appropriate cases. It is because of the multiple factors inhibiting federal prosecutors from seeking disclosures that the Administration has submitted a comprehensive package of amendments which seek to address each of the various impediments to reasonable law enforcement access to tax information.

I trust that the foregoing is responsive to the question posed during the hearing and hope that you and your staff will not hesitate to let me know if the Department can be of further assistance in providing information with respect to the various provisions of the Administration proposal.

Sincerely,

Edward C. Schmults
Deputy Attorney General

Senator **Grassley**. Has the exact language of the legislation been submitted to the Congress?

Mr. **Schmults**. It has, we have distributed it to your staff. It got up here just today, so I appreciate that you have not had a chance to review it.

Senator **Grassley**. In regard to your last paragraph, where you say, "This administration has concluded, based upon experience during almost 5 years," then I go back to the figures you gave us that prior to the 1976 act there were 1,800 requests and that had gone down to 255, and then through some effort that had gone back up to 350. Is there connected with this an indication that crime has gone up directly related to the inability to use this information?

Mr. **Schmults**. Mr. Chairman, I don't think that it would be fair to say that crime has gone up as a result of the inability to use the information. Our point is, as we all know, crime is a very, very serious problem, particularly when you are talking about drug trafficking, as Senator Chiles did, and organized crime, and that access to tax information in a carefully controlled way is certainly desirable. The proposals that the administration is making, in effect, would protect the legitimate claims of taxpayer privacy and would not injure in any way our voluntary tax compliance system, but at the same time will make it, in carefully circumscribed situations, easier for the criminal justice agencies to get information faster.

I think speed is very important here. I believe that the GAO study indicated that it took something like 65 days on the average to get access to tax information. This is really too long. While the IRS and the Justice Department have made some administrative improvements, it just simply isn't necessary, for example, if you are going to a court and the court has to make the findings (that is, you have to establish to the satisfaction of the court the need for the information) for a request to travel from the field to Washington, and then have it go back out to the field in order to get to the court. We see no reason why the U.S. attorney, or the head of a strike force, should not have authority to go directly to the court.

Senator GRASSLEY. I guess I would like to have you state that having access or requesting information on 1,800 cases, as compared to 255 for another year, and 350 for the most recent year, is related to a need for investigation, as opposed to the things that Senator Baucus, for instance, is concerned about, just the fishing expedition type of use.

Mr. SCHMULTS. It is certainly true, and I think my statement addresses that point. There is certainly a clear need for this tax and financial related information in prosecuting drug dealers, and the higher-ups in organized crime.

I think that the falloff, and the inability of Federal prosecutors—I should not say inability, but the great difficulty they have in obtaining this information, is discouraging to them, and it is something that we ought not to do lightly.

A better balance can be struck, and on the basis of 5 years of experience, it is our recommendation that, and this is true of Senator Nunn's bill as well, the Congress take another look at access to tax information and strike a better balance on the basis of the experience we have had with the Tax Reform Act.

Senator GRASSLEY. Since the concept of S. 732 and the administration's proposal is the use of IRS information to assist other Federal agencies in enforcing the Federal criminal laws, why is there a need to disclose the information to State authorities?

I know you did speak to that in your emphasis on that point, but you did not speak directly to the question.

Mr. SCHMULTS. Certainly, the problem of dealing with crime broadly falls primarily on State and local agencies. That is particularly true in violent crime. The point in the bill is that where a Federal prosecutor has tax information, because the target, if you will, is suspected of a Federal crime, and has gone to a court or otherwise obtained the tax information in a lawful manner, and then he ascertains or has reason to believe that in fact the same target has committed a State felony, it seems reasonable for the Federal Government, having that information in its possession, to turn it over only, and I stress this, only to the State attorney general or the district attorney, and even then only after the Federal prosecutor has gone to a court and established to the court's satisfaction that the information ought to be turned over.

To have this information be in the hands of the Federal Government, under the circumstances where there is clear evidence of a State felony, and not turn it over to the State to prosecute criminals would be a very serious mistake in our view. We see no sort of privacy or other interests being jeopardized here. We simply ought to be making better use of this information to prosecute nontax crimes. It is very important.

Senator GRASSLEY. You are not indicating in any way that an individual's Federal tax return would show evidence of criminal activity, whereas the State tax return might not?

Mr. SCHMULTS. That might be true, but my point does not go to that question.

I do emphasize that the State and local officials cannot make a request. This is in the hands of Federal prosecutors. There is no history of abuse of this information by Federal prosecutors.

Senator GRASSLEY. Once the IRS has released information to a Federal agency, what restrictions are there in the administration's proposal on the redisclosure of the IRS information?

Mr. SCHMULTS. The restrictions, of course, would subject anyone who rediscloses tax information in violation of the law to criminals and civil penalties. Over and above that, of course, there would be administrative and disciplinary proceedings. So there is considerable deterrence here, we believe, to assure that tax information is not redisclosed to unauthorized persons.

Senator GRASSLEY. Since Federal investigators and prosecutors can obtain almost as much tax information under current law as under the administration's proposal, is it your conclusion that Federal investigators and prosecutors currently are not attempting to get relevant tax information because of the administrative steps necessary to obtain the information?

Mr. SCHMULTS. Yes; that is my information.

Senator GRASSLEY. Would you characterize your problems with the current law as not being able to obtain enough tax information, or is it not being able to obtain the information in a timely fashion?

Mr. SCHMULTS. Both, Mr. Chairman. I think that there is evidence that there has been information in the hands of the IRS over the years that has not been turned over to criminal justice agencies for use in prosecution. Of course, the delay and the procedural morass is discouraging to Federal prosecutors.

On both of those points, both the administration's bill and Senator Nunn's bill do not discard the protections in the Tax Reform Act. Taxpayer information will remain very carefully controlled under the amendments we are proposing, and that Senator Nunn is proposing. We think the safeguards will remain rigid. Indeed, many of the changes just conform the law to existing practice.

Senator ~~Chiles~~ mentioned the catch-22 situation in the law, where you really have to prove that the tax information you are getting is valuable before you have even seen it, which is an impossible standard. The courts by and large have not adhered to this standard because they know it doesn't make any sense. So courts have been more reasonable than the literal language of the law. Several of our changes attempt to address that point, and I hope that you would try to keep that in mind.

Senator GRASSLEY. Generally, at what point during an investigation would you like to have IRS information?

Specifically, how much other information, which may constitute evidence of violation of Federal criminal law, would you normally have before requesting IRS information?

Mr. SCHMULTS. Mr. Chairman, that is very difficult to answer as it will vary from case to case.

It is clear that you do need some other evidence because you must have, in fact, an allegation of criminal conduct to make the formal request or to go into court. So presumably there will already be some Federal investigation underway based on nontax information evidence. As to how much that would be, I think that is really quite impossible to answer in the abstract.

Senator GRASSLEY. Under the administration's proposal, Federal agencies engaged in foreign intelligence, and counterintelligence activities will be able to obtain IRS information. How will they benefit from this information?

Mr. SCHMULTS. Do you mean in what way is it useful?

Senator GRASSLEY. Yes.

Mr. SCHMULTS. For example, when someone is living above and beyond their means, or their visible means, certainly tax information or financial information is extremely useful to have in seeing what the other sources of income are. They might be payment from a foreign government in connection with intelligence activities, or they might be payment from your grandmother's trust. That sort of information is extremely useful.

I would note in that connection that our bill provides some very tough criteria for the Attorney General to establish before he could get access to that sort of tax information. Our bill would require a personal certification by the Attorney General, and then the further protection of reports to the Congressional Intelligence Committees.

So we think that this provision is carefully circumscribed, but would be useful to the Government in a vital area.

Senator GRASSLEY. Senator Baucus.

Senator BAUCUS. Thank you, Mr. Chairman.

Thank you, Mr. Deputy Attorney General, for coming here, and we appreciate your help today.

As you understand it, what is the big problem that the Federal law enforcement agencies have? This is the same question I asked the Commissioner.

To what degree is the problem standard; is the standard too high that the Federal law enforcement officials have to meet in trying to get taxpayer return information or the returns themselves in order to prosecute Federal crimes?

Or, to what degree is the problem bureaucratic redtape delays? What is the essential problem here; to what degree is it third party information compared with return and return information?

Mr. SCHMULTS. I think that it is in part all of those things. The standard is clearly too high, as Senator Chiles indicated.

Senator BAUCUS. What part of the standard is too high?

Mr. SCHMULTS. For example, 6103(i)(1)(b)(2) requires that "there is reason to believe that such return or return information is probative evidence of a matter in issue related to the commission of the act." That is in part a catch-22 requirement. Until you have seen the return, you don't really know that. That is an example, I think, of a standard that should be changed.

Senator BAUCUS. What standard is in the administration's bill?

Mr. SCHMULTS. The standard in the administration's bill, we think, largely conforms the law to what courts have actually done, but people may differ with this.

Senator BAUCUS. What are the operative words?

Mr. SCHMULTS. There are really three tests. One, there is a reasonable cause to believe, based upon information believed to be reliable, that a specific crime has been, is being, or will be committed. That is essentially the same in the present law and in our bill.

Two, the information is sought exclusively for use in a Federal criminal investigation or proceeding concerning such crime.

Three, here is, I think, the corresponding standard—"There is reasonable cause to believe that the information may be relevant to a matter relating to the commission of such criminal act." That, in our view, is largely what the courts have done anyway, but it is helpful to clarify this in the law to prevent differing judicial interpretations.

Senator BAUCUS. Since this is what the courts have done anyway——

Mr. SCHMULTZ. In most cases.

Senator BAUCUS. If that is what the courts have done anyway in most cases, then logically the problem is not so much the standard as it is the bureaucratic delay.

Mr. SCHMULTS. Yes and no. This is a problem. I am not saying this is not a problem. I am saying that it makes sense to conform the law. It is helpful to prosecutors out there in the field to know what they can obtain and what they have to show.

Senator BAUCUS. Assuming that the judges——

Mr. SCHMULTS. And it is helpful to the judges, yes, sir.

Senator BAUCUS. Assuming that the judges are practicing commonsense.

Mr. SCHMULTS. I wish that we could assume that in all cases.

Senator BAUCUS. Again, assuming it is the case that the administration's bill is largely written to conform the law with the present practice, again I pose the question, doesn't it seem that the greater problem lies in the excessive centralization of the Justice Department procedures, or some other area than the standard?

Mr. SCHMULTS. Excessive centralization is required now by the present law. That is the next change that you have asked about a revision of the procedures.

We think it would be desirable to change those procedures, so that the requests to courts do not have to come here to Washington to Main Justice, but instead can go directly to the court at the initiation of a U.S. attorney, or the head of a strike force.

I mentioned before the need for speedy access. Under current law, a request for tax information in fact has to come to the Department of Justice and be authorized by the Assistant Attorney General, for the most part, in the Criminal Division. It takes a lot of time, and we would like to shorten and cut that process, bearing in mind that it still has to go to a court. A judge still has to be satisfied that the criteria have been met, and that is basically the taxpayer's protection here.

Senator BAUCUS. Do you know in how many cases a Federal law enforcement officer has requested certain taxpayer return information or returns themselves, where that law enforcement officer, since 1976, was declined?

Mr. SCHMULTS. No, sir. I heard you ask that of Senator Chiles. We will attempt to get that for you, if we keep information that way, and we will provide it for the record.

Senator BAUCUS. I understand, too, the administration position is that not only judges but magistrates should have this authority?

Mr. SCHMULTS. Yes, sir.

Senator BAUCUS. Why is that?

Mr. SCHMULTS. Magistrates can issue search warrants, and we really don't see any difference between issuing a search warrant, which in many ways is a lot more intrusive than obtaining tax information which has already been provided to one Federal agency, the IRS. So we think that it makes sense to have magistrates authorize access to tax information. It is, again, part of the need for speed, and so forth.

Senator BAUCUS. To what degree is the problem of Federal law enforcement agencies, the problem they face, the inability for them to get third party information, or is it more the inability of them to get taxpayer return information directly from the taxpayer or from the IRS?

Mr. SCHMULTS. As to which one is more important than the other, I don't really know. Of course, that would vary from case to case, and in the abstract, I cannot answer the question.

Senator BAUCUS. The main reason for this bill is because the dope peddlers are getting away with peddling dope.

Mr. SCHMULTS. Right.

Senator BAUCUS. So we are trying to stop that.

Mr. SCHMULTS. Yes, and organized crime as well.

Senator BAUCUS. In an effort to try to stop that, how important is the problem of obtaining third party information by the Federal law enforcement agencies, the EDA or whoever? Is it 90-10 or is it both?

Mr. SCHMULTS. It is certainly a major problem, which one is more important than the other, I would not be prepared to quantify that. They are both very important. Certainly, third party information is extremely important.

Senator BAUCUS. Obviously, I am trying to find out what the problem is, and suggest the problem directly.

Thank you.

Senator GRASSLEY. You suggested that a need for the legislation is drug trafficking and organized crime. Does the administration see this legislation as necessary for a broader array of criminal activity beyond those two you just mentioned, or basically limited to those two, or maybe, as I was going to ask more specifically, or just to help solve the problem of drug trafficking?

Mr. SCHMULTS. No, we see the problem as being across the board, I think. When you start citing examples, we should talk about organized crime as well as drug trafficking.

Senator GRASSLEY. But in the councils, where the administration decided to propose legislation, there was not just the talk of this as a tool to help solve one or two major crimes?

Mr. SCHMULTS. No, sir. We see this as important to deal with the issue of crime generally, and to strike a better, more appropriate balance between taxpayer privacy and the needs of the public to have the Federal Government get about addressing the issue of crime in a more effective way.

Senator GRASSLEY. Thank you very much for your kind testimony, your expertise, and for presenting the administration's point of view on this legislation.

Senator Sam Nunn has come to the hearing, so as I announced previously, I will call Senator Nunn to give his testimony.

Thank you for your leadership in this area. This hearing is a direct result of a commitment I made to you when your amendment was up on the floor of the Senate as an amendment to the tax bill, that we would, if the legislation did not go through, as a compromise hold this hearing. Thanks to you leadership and your request, we are here today.

STATEMENT OF HON. SAM NUNN, U.S. SENATOR FROM THE STATE OF GEORGIA

Senator **Nunn**. Thank you very much, Mr. Chairman. I appreciate very much you having these hearings this rapidly. I had hoped we would have them this year, and I had expected that it would be next year. My hopes rather than my expectations have come to pass, which is unusual in the Congress as far as timing, at least.

I also want to thank Senator Baucus for his participation in these hearings, and for his study of this issue over a long period of time. We have not always completely agreed on every detail, but he has given a great deal of time and thought to this subject, and for that I am very grateful.

Mr. Chairman, I am delighted to appear here this afternoon at the opening of this subcommittee's hearings on the proposed amendments to the Tax Reform Act of 1976. S. 732, which embodies those amendments and which I sponsored with the bipartisan support of 19 other Senators before the Senate on March 17, 1981, attempts to remedy serious problems concerning the role of the Internal Revenue Service in Federal law enforcement efforts.

S. 732 is similar to S. 2402, S. 2404, and S. 2405 which I and 10 other cosponsors introduced before the 96th Congress in March of 1980. I might add that S. 732 was passed by the Senate on July 27, 1981, which you just alluded to, as amendment 492 to the Economic Recovery Tax Act of 1981. A similar amendment was not enacted by the House of Representatives, however. The conference report concerning those provisions recommended full hearings, and of course the Conference Committee did not approve the final version, which I was disappointed in, but they had many other matters and I certainly understand that the House did not feel they had had sufficient time to study all of these issues.

I just want to offer my comments briefly today. I am going to ask the chairman to put all of my comments in the record, and I will attempt to summarize them.

Senator **Grassley**. Of course.

Senator **Nunn**. Mr. Chairman, this amendment is an outgrowth of extensive work done by the Permanent Subcommittee on Investigations, of which I was honored to serve as chairman during the 96th Congress.

Our subcommittee spent the better part of 1979 and 1980 investigating various aspects of organized crime, labor racketeering, and narcotics trafficking. As I look back on these studies and hearings, I am astounded at the size and sophistication of the menaces to the well-being of our Nation.

The underground economy is estimated at upward of $124 billion a year, of which the traffic in illegal narcotics amounts to somewhere between $44 billion and $63 billion. Included in these astronomical figures are an estimated $25 billion to $50 billion in unreported and untaxed profits.

It has long been recognized that financial investigations relying on financial and tax records are one of the most effective tools in piercing the veil of secrecy that protects those at the top of any criminal organization be it a drug smuggling operation, or a traditional organized crime family.

Indeed, it was the ability of the Internal Revenue Service to conduct sophisticated financial investigations that sent such notorious mobsters as Al Capone and Frank Costello to jail on income tax evasion charges, when other agencies were unable to gather enough evidence of nontax crimes to have them indicted, much less convicted.

We found, however, that even though organized crime and narcotics trafficking have become bigger and more sophisticated than ever before, the one law enforcement agency that the kingpin criminals fear the most, namely, the Internal Revenue Service, has largely withdrawn from the fray.

Prosecutors and others involved in Federal law enforcement testified before our subcommittee that they were hindered in doing financial investigations by the reluctance of IRS to lend them a hand in attacking those who call the shots in organized crime and narcotics trafficking.

We found that there were two prime reasons for this withdrawal by the IRS. One was the disclosure provisions of the Tax Reform Act of 1976, but it would be a mistake, Mr. Chairman, and Senator Baucus, to blame all the difficulties on this act. The other, and perhaps just as important, was a general attitude on the part of IRS officials that the agency only should collect taxes and not serve in any capacity as a law enforcement agency and cooperate on nontax crimes.

The disclosure provisions of the Tax Reform Act of 1976 are found in section 6103 of the Internal Revenue Code of 1954. They were enacted in the dying days of the 94th Congress and were intended to avoid future abuses of a Watergate nature.

Interestingly enough, and certainly there is some virtue to that act, and we retain in this revision what we think are the virtues, and that is considerable privacy for taxpayers. But the main allegations that led to the enactment of that law were the allegations relating to the White House sending down the names of certain people that they wanted investigated and, in their view, prosecuted for tax crimes. That was what gave impetus to the real thrust.

That is what many people, and I will not say most because I can't speak for the minds of the Congress at that time, but many people felt that that was the thing that was being prohibited. Our testimony was ample in all the hearings that we have had by expert witnesses that that was not touched at all by the Tax Reform Act. It is still no violation of the law for that to happen, unless it comes under a previous statute which would be malicious use of prosecution.

So the main target of the Tax Reform Act of 1976, that is the so-called enemies list, was missed. It is still not a violation of the law for the President to send the name of Max Baucus down to IRS and have him investigated, any more than it is for a citizen of Montana to turn in the name of Max Baucus and have him investigated. That target, if that was the target, and I think it was for many, was simply not covered in this law. I don't know that it should be covered, but nevertheless it was not.

In short, various congressional committees found that tax returns and tax information were made available to a number of Federal agencies for many questionable purposes. I certainly think all of us would agree that the kinds of disclosures that have gone on in the past represented an abuse of taxpayer privacy.

But I want to point out, Mr. Chairman, and Senator Baucus, that the Permanent Subcommittee on Investigations was unable to document any abuse of tax information on the part of a Federal prosecutor, and that is what we are here today to talk about—what has happened to law enforcement.

To cure these abuses, the Tax Reform Act made tax returns and most other information gathered by the IRS confidential and subject to disclosure by IRS only in accordance with very strict procedures. These procedures apply across the board and govern all disclosures to all Federal agencies. They are so sweeping that they can be compared to the use of a sledge hammer to kill an ant.

IRS agents are forbidden to disclose on their own initiative any tax return or tax return information, which is any information they gather in connection with the tax return, or taxpayer return information, which is any information they obtain from a taxpayer or his representative, such as his attorney or accountant.

I might say that these definitions have been extended to include the case where the Internal Revenue Service recovered from a trashcan outside a building certain discarded records. So the sweeping nature of it is very, very broad. In that particular case, the Drug Enforcement Administration wanted to see that information, and they were not allowed to see it because it was deemed to fall within the definitions which are very broad, sweeping, and very vague under the present law.

Let us say, for example, that IRS agents conduct an audit of the bank records of a taxpayer, and they discover in his checking statements that he has made a series of unexplained cash deposits. This may very well lead them to suspect that he has been dealing in narcotics. If, however, they tell the Drug Enforcement Administration about this evidence, they would be guilty of a felony under the Tax Reform Act.

As a result, there is very little criminal information exchanged today between IRS and the other Federal law enforcement agencies. IRS turned over an average of just 32 pieces of criminal evidence per year during 1977, 1978, and 1979. DEA officials testified at our hearings that they received no nontax criminal evidence over that same period of time.

What happens to the nontax criminal evidence that IRS comes across during the course of their investigations? Apparently, it is simply buried somewhere in the IRS files.

For example, IRS agents told our subcommittee that they found evidence of massive embezzlements when they audited a labor union's records, but they could not report this information to the

Justice Department. Thus, Justice had no information upon which to begin a nontax prosecution.

In another example, IRS agents found evidence in a taxpayer's business records that a policeman had been bribed. The evidence was never disclosed, and as far as I know sitting here today that policeman is still on the job.

In my mind, by keeping secret this evidence of criminal activity found in a taxpayer's business books and records, bank account statements, and check stubs, we have legislated, inadvertently, unintentionally, an exemption for criminals.

Our investigation has convinced me that the disclosure provisions of section 6103, coupled with the way they have been interpreted and enforced by IRS have had a highly detrimental effect on our Federal law enforcement system.

That system is complex and sophisticated. We do not have, nor do we want, a Federal police state. Instead, we have a series of agencies broken down by criminal jurisdiction that must operate with a high degree of cooperation and coordination. It is not unusual, in fact it is quite common, to combine the skills and information of many agencies to achieve any measure of success in criminal enforcement.

The language and interpretation of the Tax Reform Act, however, have caused a severe breakdown in our delicate and complex Federal law enforcement system. It has taken up to 13 months simply to receive the assistance of IRS agents in joint investigations. The Tax Reform Act and its interpretation by IRS has caused a bureaucratic nightmare in cases where Federal agencies should willingly assist each other.

Moreover, the Tax Reform Act and its interpretation by IRS have posed terrible dilemmas for Internal Revenue agents who must ignore the dictates of justice that apply to every other American, and refuse to turn over evidence of serious crimes to the appropriate authorities.

It is possible, of course, for other agencies to obtain tax returns and other IRS-gathered information under section 6103. However, they must apply for a court order in order to get tax returns, and they must make written requests to obtain other IRS information about nontax crimes such as forgery, bribery, or narcotics violations that comes from sources other than tax returns. In either situation, the requesting agency must describe the information it seeks to obtain.

The court order and written request requirements have created a catch 22 situation. Since Internal Revenue agents are forbidden to tell the other agencies of the criminal evidence they gather, it is virtually impossible for these other agencies even to know that such information exists, much less to describe that information with such particularity that they can satisfy the requirements for a court order or a written request.

In other words, section 6103 requires Federal investigative agencies to go through elaborate request procedures to obtain information that they probably do not know that IRS has. This is the catch 22 situation, and it has made all but impossible for the FBI, DEA, and other agencies to receive the cooperation and information from IRS.

I might add here that it is my opinion that the other agencies now cooperate less with IRS because of this. In other words, it is becoming a two-way street to the detriment of the tax collecting system of our Nation.

Section 6103 is only part of the reason why IRS dropped out of the cooperative law enforcement community. Another part is the attitude of the top officials of the IRS, and I hope, Mr. Chairman, that this has changed. I believe it started changing in the last year of the Carter administration, and it is my understanding that that attitude change is continuing to take place. I hope that that understanding is correct.

Between 1974 and 1980, a series of IRS Commissioners and their top aides took the view that IRS should stick to tax administration, by which they meant tax collection and only tax collection, and out of the general law enforcement arena.

They said that paying attention to ordinary taxpayers was a better way of keeping the voluntary tax collection system working than cracking down on organized criminals who pay no taxes, and who have tremendous ill-gotten gains. We have detailed this in several reports, which we have written, which we will make available for the committee and the staff.

Obviously, IRS must be aggressive in collecting the Nation's taxes, but I can certainly understand the skepticism of a smalltown waitress who is caught for underreporting her tips, when organized crime millionaires escape without reporting a cent of their illegal income. And that too many times has been the case in the past.

Our subcommittee concluded that if the average taxpayer knows that IRS can successfully collect taxes from the mob, he is a lot more likely to ante up his fair share, if for no other reason than fear, the fear of being caught.

When he sees a drug pusher prosecuted as a result of work by IRS, he is likely to have confidence in our voluntary tax collection system. On the other hand, if he sees criminals getting away with tax evasion on top of murder and extortion, his natural skepticism toward our tax policy will increase.

IRS's recent emphasis on ordinary taxpayers has not increased voluntary compliance with the tax laws. In fact, statistics compiled by both the IRS and the General Accounting Office indicate that voluntary compliance with the tax laws has decreased since the passage of the Tax Reform Act, and the subsequent withdrawal of IRS from cooperative law enforcement efforts.

Other statistics indicate the extent of IRS withdrawal. Between 1974 and the first 9 months of 1978, the number of organized crime cases, which originated from IRS-developed tax information, dropped from 620 to just 221. We believe now that there have been some changes that have taken place internally in IRS, and we think those changes have helped. But we do not believe that the job can be anywhere near complete without the enactment of this legislation.

There are several fears that I would like to tackle for just a moment about this legislation. Let me dispel some of them.

I am the first to admit that this is a very, very intricate, confusing, and very complicated area of the law, but if it is understood, I believe that the staff and the members of this committee will conclude that we have made an extraordinary effort to correct the abuses and the loopholes, without destroying the crucial privacy provisions.

Let's look at the type of information that could be disclosed only by ex parte order under our amendment as just as under existing law. This includes individual tax returns and all supporting attachments, such as W-2 forms, lists of donations to charitable and nonprofit organizations, and various other schedules.

It also includes the returns and supporting documentation of small closely held corporations, partnerships, associations, and so forth. In other words, the tax and supporting records of these organizations, in which there is a privacy expectation because they usually are closely owned by just a couple of family members or friends, will be protected just as they are today.

On the other hand, information gathered from other sources, such as from larger corporations or from third parties, such as banks, would not have the same degree of protection. The courts have consistently held that corporate information does not enjoy the same constitutional protection as individual information, nor is there the same practical privacy expectation in corporate records, simply because of the number of people in most corporations that have access to that information.

Let us look at the judicial standards that the Justice Department would have to meet before it could gain access to the information provided by a court order. In order to obtain an ex parte court order, Justice Department attorneys would have to present information believed to be reliable that establishes reasonable cause to believe that a specific criminal act has been committed.

Those attorneys would have to certify that the information is sought exclusively for use in a Federal criminal investigation or proceeding, and they would have to establish to the satisfaction of a district judge or magistrate that there is a reasonable cause to believe that the information may be relevant to a matter relating to the commission of a criminal act.

These are essentially the same standards that must be met under Federal law in order for authorities to wiretap our telephones, or put listening devices in our homes and offices. It seems to me, Mr. Chairman, that if these standards are sufficient to protect the privacy of our most personal conversations, they are also sufficient to protect the privacy of our tax information.

In addition to these privacy protections, I would point out that our bill, unlike the existing provision of the law, would channel all requests for IRS information through the Justice Department. Only one agency would be permitted to obtain tax information, and the requesting official in every case would be a Government attorney.

In other words, Mr. Chairman, our disclosure amendment is laden with safeguards for the privacy of all information we can reasonably expect to keep private. There will be no wholesale scrapping of privacy here. There will certainly be no sellout to a few law enforcement authorities who might like to see their work made easier. There certainly will be no attempt to create a breeding ground for a repeat of the Watergate abuses. And there also will be no meat-ax attempt to butcher the Tax Reform Act.

We believe we have offered a very balanced, well-thought-out effort to fine-tune section 6103 which, as the record clearly indicates, must be done. These amendments are the product of 2 years of hard work on the part of several congressional subcommittees, the Justice Department, and the IRS itself.

No one who is concerned about the privacy of tax returns or a repetition of the abuses of tax information should fear this amendment. Hard-working, law-abiding taxpayers can rest assured that the information they supply IRS will remain within that agency where it belongs.

The people that should fear this legislation are narcotics traffickers and organized crime figures and white-collar criminals who are cheating other taxpayers by not paying their fair share.

This amendment would give no additional power or abilities to IRS to gather information about ordinary taxpayers. The ordinary citizen is and always will be handled in-house by the IRS, with no need for cooperation with the FBI or DEA.

On the other hand, criminal tax evaders, who earn their money by participating in a life of crime, should receive different treatment by IRS. In cases where criminal ventures generate profits, IRS must have the capability to cooperate with and exchange information with the Federal investigative and prosecutory agencies.

It is in this very small area, criminal tax evasion, that we seek our primary change, so that IRS and other Federal law enforcement can work even more effectively against those criminals than they do today. As it now stands, the Tax Reform Act of 1976 makes it easier for IRS to go after the average taxpayer than the criminal, and I submit that this is a reversal of what we should expect.

Mr. Chairman, for generations the Internal Revenue Service led the way in this Nation's battle against organized crime and narcotics trafficking. But since 1977, it has hidden behind the disclosure provisions of the Tax Reform Act to stay out of the battle. It is now time for us to decide that IRS shall become once again the effective force for justice that it has been in the past.

We spent many long hours in drafting what we believe is a well-reasoned amendment. We will retain and do retain the very important privacy safeguards that will prevent any repetition of Watergate-type abuses, except as enumerated, which were not covered in the law of 1976. At the same time, we put a duty on IRS to cooperate once again in the fight against the ever-increasing organized crime and narcotics problems facing the Nation.

Five years of inactivity by this once effective law enforcement agency is enough. It is time now to act.

Mr. Chairman, again I want to thank you for the opportunity of presenting these provisions here today. I know my statement is long, but it is a complicated subject. I have skipped over a good bit of it that I would hope would be part of the record.

I would also like to submit a section-by-section summary as well as a comparison of the existing law with the Nunn proposal, which may be of some help as you go through this legislation.

Senator **Grassley**. Without objection, so ordered.

[Statement of Senator Nunn and additional materials follow:]

STATEMENT OF

SENATOR SAM NUNN

BEFORE THE

SUBCOMMITTEE ON OVERSIGHT OF THE INTERNAL REVENUE SERVICE
OF THE COMMITTEE ON FINANCE

NOVEMBER 9, 1981

Mr. Chairman, I am delighted to appear here this afternoon at the opening of this Subcommittee's hearings on the proposed amendments to the Tax Reform Act of 1976. S. 732, which embodies those amendments and which I sponsored with the bipartisan support of 19 other Senators before the Senate on March 17, 1981, attempts to remedy serious problems concerning the role of the Internal Revenue Service in federal law enforcement efforts.

S. 732 is similar to S. 2402, S. 2404 and S. 2405 which I and 10 other cosponsors introduced before the 96th Congress in March, 1980. This Subcommittee, then under the leadership of our distinguished colleague from Montana, Senator Baucus, held a hearing on those bills on June 20, 1980. After those hearings I undertook to revise last year's bills, taking into consideration the testimony of the various witnesses. The result is embodied in S. 732, which is before the Subcommittee today.

I might add that S. 732 was passed by the Senate on July 27, 1981, as Amendment No. 492 to the Economic Recovery Tax Act of 1981. A similar amendment was not enacted by the House of Representatives however. The Conference Report concerning these provisions recommended full hearings on S. 732 in the Senate and on its companion bill, S. 1502, in the House prior to passage. I want to thank you, Mr. Chairman, as well as the full committee and staff, for the prompt scheduling of these hearings.

I would like to take this opportunity to offer my own comments both as to the factual evidence which I believe supports and necessitates the passage of S. 732 and also concerning the provisions of the bill.

This amendment is an outgrowth of extensive work done by the Permanent Subcommittee on Investigations, of which I was honored to serve as Chariman during the 96th Congress.

Our Subcommittee spent the better part of 1979 and 1980 investigating various aspects of organized crime, labor racketeering, and narcotics trafficking. As I look back on our studies and hearings, I am astounded at the size and sophistication of these triple menaces to the well-being of our Nation.

The "underground economy" is estimated at upwards of $124 billion a year, of which the traffic in illegal narcotics amounts to somewhere betweeen $44 billion and $63 billion. Included in these astronomical figures are an estimated $25 billion to $50 billion in unreported and untaxed profits. In other words, we may not have had a deficit last year if taxes has been paid on these illegal profits.

All of this money has had a tremendous inflationary impact on the economy of several regions of the country, especially Florida, Texas and the Southwest areas bordering Mexico. Even my homestate of Georgia has experienced an increase in narcotics trafficking, for as enforcement authorities have cracked down on smuggling into Florida from South America, many traffickers have moved their operations northward.

The Permanent Subcommittee on Investigations explored this problem extensively, and in December of 1979 we conducted very thorough hearings on "Illegal Narcotics Profits." We issued a comprehensive report on this investigation in August 1980. (Senate Report No. 96-887).

It has long been recognized that financial investigations, relying on financial and tax records, are one of the most effective tools in piercing the veil of secrecy that protects those at the top of any organized crime ring -- be it a drug smuggling operation or a traditional organized crime family.

Indeed, it was the ability of the Internal Revenue Service to conduct sophisticated financial investigations that sent such notorious mobsters as Al Capone and Frank Costello to jail on income tax evasion charges when other agencies were unable to gather enough evidence of non-tax crimes to have them indicted; much less convicted.

We found, however, that even though organized crime and narcotics trafficking have become bigger and more sophisticated than ever before, the one law enforcement agency that the kingpin criminals fear most -- the IRS -- had withdrawn from the fray.

Prosecutors and others involved in Federal law enforcement testified before our Subcommittee that they were hindered in doing financial investigations by the reluctance of IRS to lend them a hand in attacking those who call the shots in organized crime and narcotics trafficking.

We found that there were two prime reasons for this withdrawal by the IRS. One was the disclosure provisions of the Tax Reform Act of 1976. The other was a general attitude on the part of IRS officials that the agency only should collect taxes and not serve in any capacity as a non-tax law enforcement agency.

The Tax Reform Act of 1976

The disclosure provisions of the Tax Reform Act of 1976 are found in Section 6103 of the Internal Revenue Code of 1954 (26 U.S.C. 6103). They were enacted in the dying days of the 94th Congress and were intended to avoid future abuses of a "Watergate" nature.

Until the act became effective, tax returns were considered to be public records, and access to them was governed by Presidential Executive order. Many Federal agencies, including the White House, had easy access to tax returns for a wide variety of uses.

During the Watergate investigations, it was revealed that the Nixon White House had used tax returns to pressure potential campaign contributors and certain other individuals who were on a White House "enemies list," and that the Administration had ordered IRS to conduct audits of its "enemies."

It also was revealed by the Senate Judiciary Committee that an IRS special service staff collected and disseminated information about thousands of individuals and groups which the IRS considered to have "extremist views and philosophies."

In short, various congressional committees found that tax returns and tax information were made available to a number of Federal agencies for many questionable purposes. I think all of us would agree that such disclosure represented an abuse of taxpayer privacy.

But I want to point out, Mr. Chairman, that the Permanent Subcommittee on Investigations was unable to document any abuse of tax information on the part of a Federal prosecutor.

To cure these abuses, the Tax Reform Act made tax returns and most other information gathered by the IRS confidential and subject to disclosure by IRS only in accordance with very strict procedures. These procedures apply across the board and govern disclosure to all Federal agencies. They are so sweeping that they can be compared to the use of a sledge hammer to kill an ant.

IRS agents are forbidden to disclose, on their own initiative, any tax return of "tax return information," which is any information they gather in connection with a tax return, or "taxpayer return information," which is any information they obtain from a taxpayer or his representative, such as his attorney or accountant.

Let us say, for example, that IRS agents conduct an audit of the bank records of a taxpayer, and they discover in his checking account statements that he has made a series of unexplained cash deposits. This may very well lead them to suspect that he has been dealing in narcotics. If they tell the Drug Enforcement Administration about this evidence, however, they would be guilty of a felony under the Tax Reform Act.

As a result, there is very little criminal information exchanged today between IRS and the other Federal law enforcement agencies. IRS turned over an average of just 32 pieces of criminal evidence per year during 1977, 1978, and 1979. DEA officials testified at our hearings that they received no nontax criminal evidence over that same period.

What happens to the nontax criminal evidence that IRS agents come across during the course of their tax investigations? Apparently, it is buried somewhere in the IRS files.

For example, IRS agents told our Subcommittee that they found evidence of massive embezzlements when they audited a labor union's records, but they could not report this information to the Justice Department. Thus, Justice had no information upon which to begin a nontax prosecution.

In another example, IRS agents found evidence in a taxpayer's business records that a policeman had been bribed. That evidence was never disclosed, and the policeman is still on the job.

These examples pale in comparison to an incident known as the case of the trash can in which DEA was investigating a chemist suspected of concocting illegal drugs. DEA learned that an IRS agent had searched the chemist's trash can and had discovered evidence that the chemist indeed was making illegal drugs. However, IRS would not volunteer this evidence to DEA.

The prosecutor subpoenaed the IRS agent and the trash can documents, but IRS cited the Tax Reform Act and refused to let the agent answer the subpoena. IRS said the trash was gathered in connection with the chemist's tax return: therefore, the prosecutor needed a court order under section 6103 to see the documents.

In my mind, by keeping secret this evidence of criminal activity found in a taxpayer's business books and records, bank account statements, and check stubs, we legislated an exemption for criminals.

Our investigation has convinced me that the disclosure provisions of section 6103, coupled with the way they have been interpreted and enforced by IRS, have had a highly detrimental effect on our Federal law enforcement system.

That system is complex and sophisticated. We do not have a Federal police state. Instead, we have a series of agencies broken down by criminal jurisdiction that must operate with a high degree of coordination and cooperation. It is not unusual, in fact it is quite common, to combine the skills and information of many agencies to achieve any measure of success in criminal enforcement.

IRS has a fine tradition and history of being one of the most effective law enforcement agencies, especially in cases involving high echelon criminals. Obviously, since the purpose of criminal ventures is to make money, very few substantive crimes can be committed without some tax consequence. Therefore, IRS always has been -- and continues to be -- a key agency both in terms of financial expertise and in terms of financial information.

The language and interpretation of the Tax Reform Act, however, have caused a severe breakdown in our delicate and complex Federal law enforcement system. It has taken up to 13 months simply to receive the assistance of IRS agents in joint investigations. The Tax Reform Act and its interpretation by IRS has caused a bureaucratic nightmare in cases where Federal agencies should willingly assist each other. Moreover, the Tax Reform Act and its interpretations by IRS have made, in effect, common criminals out of IRS agents who must ignore the dictates of justice for every other American, and refuse to turn over evidence of serious crimes to the appropriate authorities.

The "Catch 22"

It is possible, of course, for other agencies to obtain tax returns and other IRS-gathered information under section 6103. However, they must apply for a court order in order to get tax returns, and they must make written requests to obtain other IRS information about non-tax crimes such as forgery, bribery, or narcotics violations that comes from sources other than tax returns.

In either situation, the requesting agency must describe the information it seeks to obtain.

The court order and written request requirements have created a "Catch 22" situation. Since IRS agents are forbidden to tell the other agencies of the criminal evidence they gather, it is virtually impossible for these other agencies even to know that such information exists, much less to describe that information with such particularity that they can satisfy the requirements for a court order or written request.

In other words, section 6103 required federal investigative agencies to go through elaborate request procedures to obtain information that they may not even know that IRS has.

This "Catch 22" situation has made it all but impossible for the FBI, DEA, and other agencies to receive the necessary information and cooperation from the IRS.

IRS Attitude

Section 6103 is only a part of the reason why IRS dropped out of the cooperative law enforcement community. Another part is the attitude of the top officials of the IRS and the policies and procedures they adopted in interpreting and applying section 6103.

Between 1974 and 1980, a series of IRS commissioners and their top aides took the view that IRS should stick to "tax administration" -- by which they meant tax collection and only tax collection -- and out of the general law enforcement arena.

They said that paying attention to ordinary taxpayers was a better way of keeping the voluntary tax collection system working than was cracking down on organized criminals who pay no taxes on their tremendous ill-gotten gains.

In our report on "Illegal Narcotics Profits," the Permanent Subcommittee on Investigations differed with that view of tax administration.

Obviously, IRS must be aggresive in collecting the Nation's taxes, but we understand the skepticism of a small town waitress who is caught for under-reporting her tips when organized crime millionaires escape without reporting a cent of their illegal income.

Our Subcommittee concluded that if the average taxpayer knows that IRS can successfully collect taxes from the mob, he is a lot more likely to ante up his fair share -- if for no other reason than the fear of being caught.

When he sees a drug pusher prosecuted as the result of work by the IRS, he is likely to have confidence in our voluntary tax collection system and feel that his taxes are being well spent, especially on law enforcement. On the other hand, if he sees criminals getting away with tax evasion on top of murder and extortion, his natural skepticism toward our tax policy will increase.

IRS' recent emphasis on ordinary taxpayers has not increased voluntary compliance with the tax laws. In fact, statistics compiled by both the IRS and the General Accounting Office indicate that voluntary compliance with the tax laws actually has decreased since passage of the Tax Reform Act of 1976 and the subsequent withdrawal of IRS from cooperative law enforcement efforts aimed at big-time criminals.

The GAO findings also refute the contention that voluntary compliance is in direct proportion to the degree of confidentiality of tax return information. If that is so, then the total confidentiality of the Tax Reform Act would have resulted in total compliance. Obviously, it has not.

Other statistics indicated the extent of IRS withdrawal: between 1974 and the first nine months of 1978, the number of organized crime cases which originated from IRS-developed tax information dropped from 620 to just 221.

Partially as a result of our Subcommittee's work, the Carter Administration ordered IRS to step up its investigations of suspected narcotics dealers and organized criminals. IRS has devoted more of its resources to these efforts, and it has adjusted some of its policies and interpretations with respect to the disclosure of non-tax criminal evidence obtained by its agents.

These are steps in the right direction; however, we still need to fine-tune the Tax Reform Act of 1976 in order to remove some serious and unnecessary roadblocks to IRS active participation in federal law enforcement.

Diclosure Amendments

Our amendments will not scrap the privacy safeguards which were written into the Tax Reform Act, but it will strike a balance so that IRS can and will again cooperate with federal prosecutors, to whom no documented abuse of tax information has been attributed.

Let me try to dispel some of the unfounded fears of our disclosure amendment by explaining how its provisions will protect the privacy of tax returns and other information supplied to IRS. I am sure that once these provisions are understood -- and I admit this is an intricate, sometimes confusing area of the law -- they will be accurately seen for their privacy merits as well as their attempt to improve law enforcement.

Let's look at the types of information that could be disclosed only by ex parte court order just as under existing law. This includes individual tax returns and all supporting attachments, such as W-2 forms, lists of donations to charitable and non-profit organizations, and various other schedules.

It also includes the returns and supporting documentation of small closely held corporations, partnerships, associations, unions or other entities consisting of no more than two owners or members. In other words, the tax and supporting records of these organizations -- in which there is a privacy expectation because they usually are closely owned by only two family members or friends -- will be protected just as they are today.

On the other hand, information gathered from other sources, such as from larger corporations or from third parties, such as banks, would not have the same degree of protection. The courts have consistently held that corporate information does not enjoy the same constitutional protections as individual information; nor is there the same practical privacy expectation in corporate records, simply because of the number of people in most corporations who have access to that information. We really cannot expect the same degree of privacy for information about us that is maintained by third parties as we do for information that is in our own possession.

The fact of the matter is that other Government agencies, such as the Securities and Exchange Commission and the Department of Labor have access to similar information concerning entities, but those agencies, unlike IRS, have no disclosure prohibitions to interfere with their referring criminal information to the Justice Department, which they do on a regular basis.

Let us look at the judicial standards that the Justice Department would have to meet before it could gain access to the information protected by court order. In order to obtain an ex parte order, Justice Department attorneys would have to present information believed to be reliable that establishes reasonable cause to believe that a specific criminal act has been committed. Those attorneys would have to certify that the information is sought exclusively for use in a Federal criminal investigation or proceeding, and they would have to establish to the satisfaction of a district judge or magistrate that there is reasonable cause to believe that the information may be relevant to a matter relating to the commission of the criminal act.

These are essentially the same standards that must be met under federal law in order for authorities to wiretap our telephones or put listening devices in our homes and offices. It seems to me that if these standards are sufficient to protect the privacy of our most personal conversations, they also are sufficient to protect our tax information.

In addition to these privacy protections, I would point out that our bill -- unlike the existing provision of the Tax Reform Act -- would channel all requests for IRS information through the Justice Department. Only one agency would be permitted to obtain tax information, and the requesting official in every case would be a government attorney.

In other words, Mr. Chairman, our disclosure amendment is laden with safeguards for the privacy of all information we can reasonably expect to keep private. There will be no wholesale scrapping of privacy here. There will be no "sell-out" to a few law enforcement authorities who might like to see their work made easier. There certainly will be no attempt here to create a breeding ground for a repeat of the so-called Watergate abuses. And there certainly will be no "meat-ax" attempt to butcher the Tax Reform Act.

On the other hand, we believe we offer a very balanced, well-thought-out effort to fine-tune section 6103 of the Internal Revenue Code, which, as the record clearly indicates, needs to be done.

These amendments are the product of two year's hard work on the part of several congressional subcommittees, the Justice Department, and the IRS itself. They have been developed in the broad daylight with the views of all sides considered.

No one who is concerned about the privacy of tax returns or a repetition of the abuses of tax information should fear this amendment. Hard working, law-abiding taxpayers can rest assured that the information they supply IRS will remain within that agency where it belongs.

The only people that need fear this legislation are narcotics traffickers and organized crime figures and white collar criminals who are contributing to inflation and who are cheating other taxpayers by not paying their fair share.

This amendment would give no additional power or abilities to IRS to gather information about ordinary taxpayers.

The ordinary citizen is and always will be handled "in-house" by the IRS with no need for cooperation with the FBI or DEA. On the other hand, criminal tax evaders, who earn their money by participating in a life of crime, receive different treatment by IRS. In cases where criminal ventures generate profits, IRS must have the capability to cooperate with and exchange information with the federal investigative and prosecutive agenices.

It is in this very small area -- criminal tax evaders -- that we seek our primary change so that IRS and other federal law enforcement agencies can work even more effectively together against these criminals than they can today. As it now stands, the Tax Reform Act of 1976 makes it much easier for IRS to go after the average taxpayer than the criminal. This is a complete reversal of the societal priorities that we should be encouraging.

Civil Damage Provisions

The Tax Reform Act of 1976 contains severe criminal and civil penalities for persons who disclose tax returns or related information in violation of the Act.

The civil damage provision, 26 U.S.C. 7217, makes any person who willfully or negligently discloses a tax return or tax return information in violation of the Act personally liable for civil damages in a suit brought against him by the taxpayer.

Existing law provides that there is no civil liability for disclosures which result from good faith, but wrong, interpretations of the Act.

Our proposed change to section 7217 provides that the Government will be liable for damages awarded against a Federal official or employee so long as the disclosure occurred within the scope of his employment and was not done corruptly, maliciously, in return for anything of value, or willfully in violation of the disclosure provisions of the Act.

We do not believe that IRS agents should be personally liable for damages arising out of disclosures which are not done with wrongful intent, and our proposal spells this out.

Criminal Penalties

The criminal penalties of the Tax Reform Act, 26 U.S.C. 7213, make it a felony to willfully disclose tax returns or tax return information in violation of the Act. Persons found guilty can be fined up to $5,000 or sentenced to jail for up to 5 years, or both, and assessed the costs of prosecution.

Under existing law, there is no defense available for good faith but wrong interpretations of the disclosure provisions. As a result, IRS agents testified before our Subcommittee, they will always stay on the safe side of the law and not disclose any IRS information to other agencies except in the most serious situations. The disclosure provisions are not always easy to interpret in every situation when an IRS agent comes across evidence of a nontax crime. In fact, even though IRS has issued a number of "clarifying" interpretations and instructions, its agents testified that they never could be sure if they were violating the Act when they disclosed information. In fact, IRS's own legal counsel had difficulty interpreting the provisions when asked questions at our hearings.

In order to ease the minds of IRS agents and to encourage them to report nonreturn information of possible crimes, we propose that an affirmative defense provision be added to the criminal penalty section to relieve them of criminal liability when they can establish that they made the disclosure based on good faith, though erroneous, interpretation of the disclosure provisions.

Conclusion

Mr. Chairman, for generations the Internal Revenue Service led the way in this Nation's battle against organized crime and narcotics trafficking, but since 1977 it has hidden behind the disclosure provisions of the Tax Reform Act to stay out of the fray.

It is now time for us to decide that IRS shall become once again the effective force for justice that it was in the days of bootleggers and rumrunners. Our proposals will send IRS a clear and unmistakable signal that it should do just that.

We have spent many long hours in drafting what we feel is a very well-reasoned amendment. We will retain very important privacy safeguards that will prevent any repetition of Watergate-type abuses. At the same time, we put a duty on IRS to cooperate once again with the fight against the ever increasing organized crime and narcotics problems facing the Nation.

Five years of inactivity by this once effective law enforcement agency is enough. It is time to act.

Mr. Chairman, my full statement, together with a section-by-section analysis of S. 732 and a comparison of it to existing law appears in the March 17, 1981 Congressional Record. I would like to present a copy of that for the record of these hearings.

I thank you and the Subcommittee for this opportunity to discuss the provisions of S. 732, and I would be pleased to answer any questions you may have.

Disclosure Provisions
Comparison of Existing Law to Nunn Proposal

26 USC 6103 Existing Law	NUNN Proposal	Comments
(a) General Rule--"Returns" and "return information shall be confidential, and no person who had had access to returns or return information shall disclose the returns or information, except as authorized in §6103.	Change in nomenclature to reflect new terms "return information" and "non-return information" vice "returns" and "return information."	
(b) Definitions		
(1) Return--Tax or information return, declaration or estimated tax or claim for refund, or claim for refund, or amending or supplement thereto, including supporting schedules, attachments, or lists which are supplemental to, or part of, the filed return.	(1) Return information--Includes tax returns and supporting documentation now covered under "return" and "any information provided by or on behalf of an individual taxpayer [including natural persons or corporatives, partnership, association, union or other entity consisting of no more than 2 owners, shareholders, partners, or members] to whom such information relates." (See (b)(3) below.)	The 3 existing definitions are reduced to 2. DOJ must obtain an ex parte order to gain access to tax returns, supporting submissions, or any other information submitted to IRS with respect to an individual or a small corporation, partnership, association, union, or other entity made up of no more than two members. The records of a small corporation owned by a man and his wife, for example, will be protected by the court order provision. Records of a large corporation other than tax returns and other accompanying documents required by law to be supplied to IRS (in which privacy expectations are less because a number of persons have access to the information) would not be covered by a court order but would require a formal request from the DOJ to IRS.
(2) Return Information--A taxpayer's identity; the nature, source or amount of his income, payments, receipts, deductions, exemptions, credits assets, liabilities, net worth, tax liability, tax withheld, deficiencies, overassessments, or tax payments; whether the taxpayer's return was, is being, or will be examined or subject to investigation or processing; any other data received, recorded, prepared, or collected by, or furnished to a determination of tax liability; any written determination, or any background file document relating to such determination, which is not open for public inspection.	(2) Non-Return Information--Any other information in possession of IRS except data in a form which cannot be used to identify, directly or indirectly, a particular taxpayer.	Information which does not identify a particular taxpayer, such as statistical data and rulings which do not identify the taxpayer, may be disclosed without a court order.

26 USC 6103 Existing Law	NUNN Proposal	Comments
(3) Taxpayer return information--Return information (as in (2)) which is filed with, or furnished to, IRS by or on behalf of the taxpayer or to whom such information relates.	(3) Individual Taxpayer--Any natural person or a corporation, partnership, association, union, or other entity consisting of no more than 2 owners, shareholders, partners, or members.	Carter administration and other witnesses advocated keeping the books and records of small corporations, etc., within the court order provision since these usually are, for all practical purposes, owned by a single individual, who has an expectation that these records will remain private. In the case of larger corporations, the courts have made clear that no such privacy expectation is present.
(i) Disclosure for administration of Federal laws Federal laws not relating to tax administration.	(1) Disclosure of return information	
(1) Non-tax criminal investigation--		
(A) Information from taxpayer--Upon grant of an ex parte order by a Federal district court judge, a return or taxpayer return information shall be open, but only to the extent necessary as provided in the order, to officers or employees of a Federal agency who are personally and directly engaged in --and solely for their use in--preparation of any administrative or judicial proceeding (or investigation which may result in such a proceeding) pertaining to the enforcement of a specifically designated Federal criminal statute	(A) Return information shall be disclosed, pursuant to an ex parte order of a federal district court judge or magistrate, to officers and employees of the Justice Department who are personally and directly engaged in and solely for their use in preparation for any administrative, judicial, or grand jury proceeding (or investigation which may result in such a proceeding) pertaining to the enforcement of a specifically designated federal criminal statute (not involving tax administration). The order may provide for continuous disclosure if justified under subparagraph (B)(iii) [i.e., there is reasonable cause to believe the information may be relevant to a matter relating to commission of a criminal act].	Disclosure of return information would be permitted only to Justice Department personnel, not to those of other federal agencies as now permitted, and only for use in a criminal proceeding or investigation. This provides an additional check on the appropriatness and legality of disclosure. Magistrates, who may issue search warrants, would be allowed to issue ex parte disclosure orders as well as district judges. The present statute had a privision which included return information which had been loosely interpreted to cover taxpayer books and records, accountants' books and records, corporate records, third-party interviews, tips from other agencies and other material by law to provide IRS. Thus, the present act had the unfortunate result of putting IRS in the position of discovering bribery, embezzlement, union payoffs, etc. in financial records of organizations but not being able to turn it over or tell the Justice Department about it.

26 USC 6103 Existing Law	HUNN Proposal	Comments
(B) Application for order--The head of any Federal agency described in (A) or, if the Justice Department, the AG, Deputy AG, or Assistant AG, may authorize an application for an ex parte order.	(B) Application for order--The Attorney General, Deputy AG, an Assistant AG, a United States Attorney, or the Attorney-in-charge of a Criminal Division Organized Crime Strike Force may authorize an application for an ex parte order.	Applications for ex parte orders could be made only by certain DOJ officials, not by officials of other agencies. This is an additional privacy safeguard not in existing law.
The Judge may grant the order if he determines on the basis of facts submitted by the applicant that--	The judge or magistrate may grant the order if he determines on the basis of facts submitted that--	The existing standards require DOJ to describe with specificity tax information that its attorneys have never seen. This leads to a "catch-22" situation. The proposed changes would establish standards similar to those now required under the federal wire tap statutes. While they would eliminate the "catch-22" aspects, they are high enough to protect against indiscriminate violations of individual privacy.
(i) there is reasonable cause to believe, based on information believed to be reliable, that a specific criminal act has been committed;	(i) [no change]	
(ii) there is reason to believe that such return or return information is probative evidence of a matter in issue related to the commission of such criminal act; and	(ii) the information is sought exclusively for use in a federal criminal investigation or proceeding concerning such act; and	The proposed standard is more reasonable with the added safeguard of prosecutorial intervention. The main criticism of the present standard was that it was impossible to meet. Therefore, no one used it.
(iii) the information sought to be disclosed cannot reasonably be obtained from any other source, unless the information constitutes the most probative evidence of a matter in issue relating to the commission of such criminal act.	(iii) there is reasonable cause to believe that the information may be relevant to a matter relating to the commission of such criminal act.	Also we've eliminated the third requirement that the Government prove the financial information cannot be obtained from any other source. The fact is that the financial information is "available" elsewhere but that the Government would have to completely reconstruct a taxpayer's bank records to duplicate the information on the return. This third requirement of the present act also requires the Government to prove that the tax return was the most probative evidence of the crime to be proven. Since this section deals only with non-tax crimes, the tax return itself would never be the most probative evidence of the crime. Only the actual financial record would qualify. Thus an impossible standard would be deleted.
However, IRS shall not disclose any return or return information if it determines and certifies to the court that such disclosure would identify a confidential informant or seriously impair a civil or criminal tax investigation.	No change.	

26 USC §6103 Existing Law	NUNN Proposal	Comments
No similar provision.	(C) Duty of IRS--IRS shall disclose to the appropriate Justice Department attorney such information ordered disclosed as soon as practicable following receipt of the ex parte order.	Witnesses testified that even when an order is obtained under existing §6103, IRS has taken inordinate time to comply, even to the point of jeopardizing criminal trials. This new provision would remedy those delays.
Further disclosure is governed by (i)(1)(A) above.	(D) Further disclosure--The government attorney may further disclose return information to such other federal government personnel or witness as he deems necessary to assist him in a criminal investigation or in preparation for the administrative, judicial or grand jury proceeding upon which the ex parte order is based.	Essentially, there would be no change in further disclosure as a practical matter. This language is similar to that already contained in Rule 6(e) of the Federal Rules of Criminal Procedure, regarding the release of secret grand jury evidence.
(2) Return information other than taxpayer return information--Upon written request by agency heads authorized to apply for ex parte order [para. (1)(A)], information supplied by third parties (i.e., return information not supplied by or on behalf of a taxpayer) shall be disclosed to officers and employees of such agency personally and directly engaged in, and solely for their use in, preparation for any administrative or judicial proceeding (or investigation which may result in such a proceeding).	(2) Disclosure of Nonreturn information. (A) Upon written request from the head of a federal agency, the Inspector General thereof, or the Attorney General or his designee in the case of the Justice Department, the IRS shall disclose nonreturn information as soon as practicable to officers and employees of such agency personally and directly engaged in, and solely for their sue in preparation for any administrative, judicial, or grand jury proceeding (or investigation which may result in such a proceeding) as described in paragraph (1)(A).	The procedures for requesting nonreturn information would not be altered substantially. However, since the definitions would be changed, more information--such as corporate records, third party records, and witness interviews--could be produced pursuant to written request rather than by court order than is the case under existing law.

26 USC §6103 Existing Law	NUNN Proposal	Comments
Such written request shall set forth--	Such written request shall set forth--	
(A) the name and address of the taxpayer;	(i) the name and address of the taxpayer;	
(B) taxable period(s) to which the return information relates;	(ii) the taxable period(s) to which the nonreturn information relates;	
(C) the statutory authority under which the proceeding or investigation is being conducted; and	(iii) the statutory authority under which the proceeding or investigation is being conducted, and	
(D) the specific reason(s) why such disclosure is or may be material to the proceeding or investigation.	(iv) allegations of criminal conduct giving role to the proceeding or investigation.	Since it is DOJ and not IRS which must determine if evidence is material to a criminal proceeding or investigation, the change would require DOJ merely to cite the conduct which gave rise to the request.
However, IRS shall not disclose any return or return information if it determines that such disclosure would identify a confidential informant or seriously impair a civil or criminal tax investigation. The name and address of a taxpayer may be disclosed under this paragraph.	No Change.	
No specific provision on further disclosure (see(i)(2) above).	(B) Further disclosure--The agency head, an I.G., or the AG or his designee may further disclose nonreturn information to such federal personnel or witness as he deems necessary to assist him in preparation for the administrative, judicial, or grand jury proceeding upon which the request is based.	There would be no substantial change in further disclosure except permit disclosure to witnesses, who often must be shown evidence during an investigation or in preparation for a criminal proceeding. This is the same procedure now in effect pursuant to Rule 6(e), Federal Rules of Criminal Procedure concerning the disclosure of secret grand jury evidence.

26 USC §6103 Existing Law	NUNN Proposal	Comments
Under paragraph (i)(1), taxpayer identity information is considered to be taxpayer return information and subject to disclosure only by grant of an ex parte order. However, under paragraph (i)(2), taxpayer identity information may be disclosed in connection with the disclosure, pursuant to written request, of return information other than that provided by or on behalf of a taxpayer (i.e., third-party information).	(C) For this purpose, the name, address and social security number of a taxpayer, whether a taxpayer filed a return for a given year or years, and whether there is or has been a criminal investigation of a taxpayer shall be treated as non-return information.	Our section makes it clear that taxpayer identification information is available upon written request of the attorney for the government. This avoids problems such as those faced by law enforcement officers when trying to return stolen property according to social security numbers and IRS won't provide the information under the present act.
(3) Disclosure of return information concerning possible criminal activities--IRS may disclose in writing return information (other than that provided by or on behalf of a taxpayer) which may constitute evidence of a violation of Federal criminal laws to the extent necessary to apprise the head of the appropriate Federal agency charged with enforcing such laws. The name and address of a taxpayer may be disclosed, even though supplied by the taxpayer, if there is thid-party return information that may constitute evidence of a Federal crime.	(3) Secretary's duty to disclose nonreturn criminal information. (A) The IRS shall disclose, as soon as practicable and in writing, nonreturn information which may constitute evidence of a violation of federal criminal laws to the extent necessary to apprise the head of the appropriate federal agency or his designee charged with the responsibility for enforcing such laws. For this purpose, the name and address of the taxpayer shall be treated as nonreturn information.	Present law merely permits IRS to disclose third-party criminal information to DOJ. The change would put an affirmative burden on IRS to carry out every citizens basic duty to report evidence of crime, except where the information is return information. Our section requires the IRS to disclose criminal information it uncovers except anything listed on the tax return itself and accompanying records. Under the present act IRS is not required to disclose the information [and the evidence at the PSI hearing disclosed that they didn't]. The tax return would still be inviolate except via court order. This section eliminates the "catch-22" situation of requiring an agency to request information without ever knowing what information exists. This section also would require IRS to alert the Justice Department to criminal information.

26 USC s6103 Existing Law	NUNN Proposal	Comments
No similar provision.	(B) In addition to the above disclosures, whenever IRS recommends to DOJ a prosecution for tax law violation, it shall furnish to DOJ any return or nonreturn information reviewed, developed, or obtained during the tax investigation which may constitute evidence of a violation of federal criminal laws.	Once IRS has recommended a tax prosecution to DOJ, it can disclose tax information relating to the case. This minor alteration would only allow IRS, after it has recommended a tax case to DOJ for prosecution, the ability to give DOJ all information associated with that case.
IRS shall not disclose any return or return information if it determines that such disclosure would identify a confidential informant or seriously impair a civil or criminal tax investigation.	(C) However, IRS may decline to disclose any information under the above paragraphs if it determines that such disclosure would identify a confidential informant or seriously impair a civil or criminal tax investigation.	No change in substance.
No similar provision.	(4) Use in judicial or administrative proceeding--Any information obtained under paragraphs (1), (2), or (3) may be entered into evidence in accordance with the Federal Rules of Evidence or other applicable law in any administrative, judicial, or grand jury proceeding pertaining to the enforcement of a specifically designated federal criminal statute (not including tax administration) or any ancillary civil proceeding to which the United States or any agency thereof is a party.	This section codifies the commonly accepted rise of tax returns obtained pursuant to 6103 in federal courts according to the appropriate rules evidence. This section would also provide a mechanism to transfer information concerning federal civil litigation to the appropriate federal authority. Under the present act, no such provision exists. GAO found, for instance, that the Government under the present act lost federal civil cases of substantial size because it could not obtain information from IRS. This section would provide a mechanism to transfer information in serious civil cases such as civil rights, anti-trust and fraud cases which an ancillary to a criminal proceeding.

26 USC §6103 Existing Law	NUNN Proposal	Comments
No similar provisions	Any such information may be disclosed to the extent required by order of a court pursuant to 18 USC 3500 or Rule 16 of the federal Rules of Criminal Procedure, or other applicable discovery requirements, such court being authorized in the issuance of such order to give due consideration to congressional policy favoring the confidentiality of return and nonreturn information as set forth in this title. However, any information obtained under paragraphs (1), (2), or (3) shall not be admitted into evidence in such proceeding if IRS determines and notifies the AG or designee or the head of such agency that such admission would identify a confidential informant or seriously impair a civil or criminal tax investigation, unless the court shall otherwise direct such disclosure.	
No similar provision.	(5) Emergency circumstances--Under emergency circumstances involving an imminent danger of physical injury to any person, serious physical damage to property, or flight from prosecution, IRS may disclose information, including return information, to the extent necessary to apprise the appropriate federal agency of such emergency. As soon as practicable thereafter, IRS shall notify DOJ of this action, and DOJ shall thereupon notify the appropriate federal district court or magistrate of the disclosure.	This section allows IRS to disclose any information to the appropriate agency in circumstances where a threat exists of injury to a person, serious damage to property, or flight from prosecution. This obviates problems that exist under the present law where even threats of assassination couldn't be disclosed without elaborate and time-consuming procedures. This section requires that after the emergency disclosure, the Government notify the appropriate court of the disclosure.

26 USC §6103 Existing Law	NUNN Proposal	Comments
No similar provisions.	(6) Assistance of IRS in joint tax and non-tax investigations--No portion of §6103 shall be interpreted to preclude or prevent IRS from assisting any other federal investigative agency in investigations of criminal matters which may lead to income tax violations, or from investigating or gathering relevant information concerning persons involved in such criminal activities.	This section makes it clear on the face of the statute that IRS is free to work jointly with other government agencies in combating crime. This is to obviate the need to process a Title 26 Grand Jury request simply to obtain the assistance of IRS. Hearing testimony revealed that the Grand Jury request process took upwards of one year just to obtain the services of IRS in a criminal case.
	(7) Disclosure to State authority upon certification of evidence of a State felone violation--the official to whom disclosure has been made may apply to a district court for an ex parte order to further disclose to a State Attorney General or district attorney any return or nonreturn information that is relevant to a violation of a State felony statute. The application shall set forth the name and address of the taxpayer, the relevant taxable period(s), the State felong violation and statute, and a description of the information sought to be disclosed.	This section gives the government a mechanism to provide evidence of state crimes to the appropriate authorities. The present act contained no such provision. This section provides for a court-authorized procedure to give evidence of state crimes to state authorities. Under the present act, for instance, evidence of bribing a policeman in the hands of IRS sould not be given to the appropriate state authorities. Our revision provides a mechanism to accomplish this which includes a court order as a privacy safeguard.

26 USC §6103 Existing Law	NUNN Proposal	Comments
No similar provision.	The order for discloure to State authorities may be granted if the judge or magistrate finds on the facts submitted that-- (A) there is reasonable cause to believe, based on information believed to be reliable, that a specific state felong violation has occurred; and (B) there is reasonable cause to believe that the information may be relevant to a matter relating to the commission of such violation.	
No similar provisions.	(k)(4) Disclosure to competent authority under international convention--Return or non-return information may be disclosed to competent authority of a foreign government which has a tax convention, mutual assistance treaty, or other convention relating to the exchange of tax information with the U.S. but only to the terms of the agreement. Disclosure of return or nonreturn information sought pursuant to a treaty or convention for use in non-tax criminal matters may be made only after a U.S. district judge or magistrate issued an ex parte order that there is-- (A) reasonable cause to believe that the information may be relevant to a matter of a specific criminal act that has been committed or is being committed against the laws of the foreign country, and (B) that the information is sought exclusively for us in such country's criminal investigation or proceeding concerning criminal act.	This section creates a mechanism to allow the Government to perform according to mutual assistance treaties it has entered into with foreign countries to exchange criminal evidence. Under the present act, IRS refused to give criminal evidence to the Justice Department so that it could comply with this country's mutual assistance treaties.

26 USC §6103 Existing Law	NUNN Proposal (Criminal Penalty for Disclosure)	Comments
(a)(1) It shall be unlawful for any present or former officer or employee of the federal government to willfully disclose any return or return information except as authorized in 26 USC 6103. A violation is punishable by a fine not exceeding $5,000 or 5 years in prison, or both, together with the costs of prosecution, and any person convicted of a violation shall be discharged from Government employ.	No change.	----
	(d) It shall be an affirmative defense that such disclosure of return or nonreturn information resulted from a good faith, but erroneous, interpretation of section 6103 while a federal employee was acting within the scope of his employment.	IRS agents testified that section 6103 is very technical and detailed, and that IRS' interpretations of the section have been confusing to them. Therefore, rather risk violating 7213, which contains no good faith defense, they are "gun shy" and reluctant to disclose criminal evidence even when, as a technical, they are permitted to do so. Therefore, a good faith defense would be added to 26 USC 7213.

26 USC 7217 Existing Law	NUNN Proposal	Comments
	(Civil Penalties for Disclosures) : :	
(a) General rule--Whenever any person knowingly, or by reason of negligence, discloses a return or return information in violation of section 6103, the taxpayer may bring a civil action for damages against such person.	(a) General rule--Whenever any federal employee knowingly, or by reason of negligence, discloses return or nonreturn information in violation of section 6103, the taxpayer may bring a civil action for damages exclusively against the agency employing that employee. Whenever any person other than a federal employee discloses return or nonreturn information in violation of section 6103, the taxpayer may bring a civil action directly against such person.	The change shifts liability for damages for authorized disclosure in the case of a federal employee from the individual employee to the Government.

SECTION-BY-SECTION SUMMARY
OF PROPOSED AMENDMENTS TO 26 U.S.C. 6103,
26 U.S.C. 7213, AND 26 U.S.C. 7217

This bill would streamline and clarify provisions of the Internal Revenue Code governing access to tax information for use in non-tax criminal investigations and prosecutions. The bill combines the salient features of Senate-initiated proposals and those developed by the carter administration. This compromise measure is based on more than eight months of study and hearings by four Congressional committees. Generally, the bill would clarify ambiguities in existing law, refine needlessly cumbersome procedures, and distinguish between privacy rights of individuals as contrasted with those of legal entities such as corporations. The modest changes proposed would substantially assist federal law enforcement authorities in combatting narcotics trafficking, organized crime and white-collar offenses involving large sums of money. At the same time, the bill preserves the safeguards for taxpayer privacy established in 1976.

Definitions of Protected Information
[26 U.S.C. 6103(b)(1-3)]

Existing law uses a baffling series of four terms to describe information held by IRS, i.e., "returns," "return information," "taxpayer return information," and "return information other than taxpayer return information." S. 2402 would clarify the law by adopting a workable two-part definitional structure.

Section 1. The new §6103(b)(1) would describe the first category of protected tax information, "return information," which includes (A) returns of all taxpayers and (B) underlying records and information submitted by or on behalf of "individual taxpayers," to support the filing of a tax return.

Section 2. The second category of information held by IRS, "non-return information," is defined to encompass all information held by IRS not covered by the definition of "return information."

Section 3. The bill defines the term "individual taxpayer" as an individual or a legal entity with no more than two owners, shareholders, or members, such as a small, family-owned business.

Taken together, these three definitions simplify existing law by reducing the number of categories of information from four to two; moreover, the two new categories of information conform to the methods of obtaining access: "return information" requires a court order while "non-return information" may be obtained pursuant to a formal law enforcement request under (i)(2) or pursuant to a report of crime under (i)(3). The only substantive change made by the revised definitional structure is that the books and records of legal entities, such as banks and corporations, are made available under (i) (2) or (i) (3); they are now available only under (i)(1), as are books and records of individuals.

The rationale for the distinction is that natural persons have greater privacy rights than do corporations or other entities. A similar distinction is made in the Privacy Act of 1974 (5 U.S.C. 552a) and the Financial Privacy Act of 1978 (12 U.S.C. 3401-3422), neither of which applies to corporate records. Moreover, records of corporations and other entities are normally subject to inspection by shareholders and others with an interest in the entity, as well as federal, state and local authorities; individual books and records are not. Furthermore, books and records of legal entities are normally maintained for purposes other than tax requirements; individual books and records are frequently maintained solely to comply with tax laws. Finally, the Fifth Amendment privilege against self-incrimination does not extend to legal entities.

For these reasons, S. 2402 accords a higher degree of protection to underlying books and records of individuals than to those of legal entities. Because legal entities comprised of only two persons, such as small, closely-held businesses, are usually the alter ego of an individual, they are treated as individuals. Again, it should be noted that all tax returns are accorded the higher degree of protection without regard to the nature of the taxpayer; the distinction between individuals and entities applies only to underlying information, primarily financial books and records.

Disclosure Pursuant to Court Order
[26 U.S.C. 6103(i)(1)]

Section 4, Part 1. The revised §6103(i)(1) preserves the structure of the existing court order provision. The modifications are intended only to clarify existing law and to make the literal terms of the statute comply with actual practice.

For example, the standards in existing (i)(1), if read literally, require a factual showing that cannot be made unless the prosecutor seeking access is already in possession of the information sought. Courts have interpreted this language in a commonsense fashion to require proof only of those facts a federal prosecutor can realistically be expected to demonstrate: that there is reasonable cause to believe a specific federal crime has occurred or is occurring, that there is reasonable cause to believe tax information is relevant to that offense, and that the information will be used exclusively for investigation and prosecution of that offense. S. 2402 would substitute these standards for those of existing law. Because this merely codifies present practice, it has no practical effect on taxpayer privacy or tax administration. It does, however, reduce the potential for widely varying judicial results and the extreme chilling effect that the unrealistic language of current law has on federal prosecutors who need tax information for legitimate law enforcement purposes.

The proposed standard is more reasonable, with the added safeguard of prosecutorial intervention. The main criticism of the present standard was that it was impossible to meet. Therefore, no one used it. Also, the proposed would eliminate the third requirement that the Government prove the financial information cannot be obtained from any other source. The fact is that the financial information _is_ "available" elsewhere, but the Government would have to completely reconstruct a taxpayer's bank records to duplicate the information on the return. This third requirement of the present act also requires the Government to prove that the tax return was the most probative evidence of the crime to be proven. Since this section deals only with non-tax crimes, the tax return itself would never be the most probative evidence of the crime. Only the actual financial records would qualify. Thus an impossible standard would be deleted.

The new (i)(1) modifies the class of federal officials who may authorize an application for a court order. Existing law requires all such applications to be routed through Washington for approval before being presented to the court, a requirement which results in substantial delay and paperwork. The new (i)(1)(B) would permit United States Attorneys and Attorneys-in-Charge of Organized Crime Strike Forces in the field to present applications directly to the appropriate federal court for consideration.

S. 2402 would delete the authority currently possessed by all heads of federal agencies to approve (i)(1) applications, thereby centralizing application authority in a single agency, the Department of Justice, where it can be more effectively coordinated. Since 1976, only five applications for (i)(1) orders have been signed by non-Justice Department entities; this change will not, therefore, adversely affect federal agencies.

The revised (i)(1)(D) also clarifies existing law by explicitly providing that redisclosure can be made to those support personnel necessary to prepare for a criminal prosecution. This would not change existing practice.

Finally, the new (i)(1) provides that court orders may be granted by U.S. Magistrates as well as U.S. District Judges. Magistrates are now authorized to grant analogous applications such as those for search and arrest warrants.

Disclosure Pursuant to Formal Law Enforcement Request [26 U.S.C. 6103(i)(2)]

Section 4, Part 2. The revised §6103(i)(2) clarifies existing law governing requests for non-return information. As amended, (i)(2) would permit requests to be made by Justice Department officials in the field, as designated by the Attorney General, to avoid the necessity of routing all requests through Washington. It is anticipated that the Attorney General would authorize Assistant United States Attorneys and supervisory-level officials of investigative agencies to request non-return information, i.e., officials not directly involved in an investigation. In addition to the heads of agencies now authorized to request (i)(2) information, S. 2402 would grant similar authority to the fifteen Inspectors General whose mandate is to combat fraud, waste and abuse in federal programs.

The new (i)(2)(C) also authorizes these federal law enforcement officials to inquire whether a taxpayer filed a return for a given year and whether there is or has been a criminal investigation of the taxpayer. This will help avoid the waste of resources which has occurred where a court order is sought and obtained only to find that the taxpayer did not file a return for the year in question.

Finally, the revised (i)(2) would modify the factual showing required to support a disclosure of non-return information by substituting "the allegation of criminal conduct giving rise to the proceeding or investigation" for "the specific reason or reasons why such disclosure is or may be material to the proceeding or investigation." Like the (i)(1) court order requirement, a prosecutor cannot show the materiality of tax information to a case without access to the information sought.

IRS-initiated Disclosure
[26 U.S.C. 6103(i)(3)]

Section 4, Part 3. S. 2402 proposes two improvements to the procedure by which IRS initiates reports of non-tax crime to law enforcement authorities. First, the new §6103(i)(3) would make such reports mandatory rather than discretionary. Second, the new (i)(3)(B) provides that when the IRS refers a tax case to the Department of Justice, it must also refer any evidence it has of non-tax crimes committed by the taxpayer. The purpose of the non-disclosure rule is to encourage taxpayers to report their incomes fully and honestly; taxpayers who evade taxes should not benefit from a policy enacted to encourage honest reporting. The proposed section requires the IRS to dislcose criminal information it uncovers except return information. Under the present act, IRS is not required to disclose the information [and the evidence at PSI's hearing disclosed that they do not]. This section eliminates the Catch-22 situation of requiring an agency to request information without ever knowing what information exists. It also requires IRS to alert the Justice Department to criminal information.

Admissibility of Tax Information
[26 U.S.C. 6103(i)(4)]

Section 4, Part 4. Finally, section 4 of the compromise bill would amend (i)(4) of §6103 to provide that tax information is admissible in judicial and administrative proceedings like other evidence rather than pursuant to special rules. The bill also clarifies that tax information is admissible in proceedings "ancillary" to criminal proceedings, i.e., those arising from the same course of conduct and involving the same parties. Civil proceedings ancillary to criminal proceedings include civil forfeiture or damage actions which may be pursued in addition to or in lieu of criminal prosecution.

The amendments to (i)(4) also clarify that tax information may be disclosed to a defendant pursuant to the Jencks Act, discovery provisions of the Federal Rules of Criminal Procedure or other discovery requirements. This explicitly protects a defendant's Due Process rights and is consistent with current practice.

Emergency Disclosure

Section 5, Part 1. S. 2402 would add three new paragraphs to §6103(i). The new paragraph (i)(5) would permit IRS, in its discretion, to report to the appropriate federal agency any circumstances involving an imminent danger of physical injury to any person, serious property damage or flight from prosecution. This authority for disclosure in rare emergency situations is patterned on the similar provisions of the Financial Privacy Act of 1978 (12 U.S.C. 3414(b)) and, like the Financial Privacy Act, requires that all such disclosures be reported promptly to the appropriate federal district court.

Joint Investigations

Section 5, Part 2. The new (i)(6) merely states that §6103 does not preclude or prevent IRS from assisting or working jointly with federal law enforcement agencies in the investigation of non-tax crimes which may involve violations of federal tax laws. This does not change current law, but clarifies the law which now discourages such cooperation by the vague and uncertain language in the act.

Disclosure to State and Local Authorities

Section 5, Part 3. S. 2402 also proposes a new (i)(7) authorizing carefully limited redisclosure of tax information to State and local law enforcement authorities. This limited redisclosure would be permitted only as to information already obtained by federal law enforcement officials for a federal non-tax criminal investigation. If such information reflects a State felony violation, the federal official obtaining access would be authorized to go back to court and seek an order authorizing redisclosure to the appropriate State attorney general or district attorney exclusively for use in the investigation or prosecution of that State felony violation. Like other persons receiving tax information, the State attorneys general and district attorneys receiving tax information under (i)(7) would be subject to civil and criminal sanctions for any unauthorized use.

Disclosure Pursuant to Mutual Assistance Treaties

Section 6. S. 2402 would amend §6103(k)(4) to permit disclosures to foreign governments pursuant to mutual assistance treaties for use in non-tax criminal matters such as narcotics trafficking, thereby making it possible for federal officials to obtain reciprocal disclosure of foreign tax information. Such treaties, of course, must be ratified by the Senate. To further regulate this foreign access to tax information, the amended (k)(4) would require entry of an order by a U.S. district court, similar to that required by §6103(i)(1), before a disclosure could be made. Paragraph (k)(4) presently authorizes similar disclosures to foreign governments for tax use pursuant to international tax conventions.

CRIMINAL PENALTIES

Section 7 would amend the criminal provision of the Internal Revenue Code, 26 U.S.C. 7213, to create an affirmative defense to prosecution where the disclosure of tax information in question was made pursuant to a good faith but erroneous interpretation of the law.

The new subsection would make it clear to federal employees that they need not fear criminal prosecution if they proceed reasonably and in good faith. Actually, this makes no practical change in existing law which requires a "willful" violation to sustain a conviction. It would, however, reduce the extreme chilling effect which present law has on legitimate disclosures.

CIVIL REMEDY

Section 8 would amend the civil remedy section of the Internal Revenue Code, 26 U.S.C. 7217, to make federal agencies, rather than individual federal employees, the defendants in suits alleging unauthorized disclosures of tax information. This change would conform §7217 to the Financial Privacy Act of 1978 (12 U.S.C. 3417) and the Administration's proposed Tort Claims Act amendments.

Under present law, civil suits may be filed against both the federal agency and the employee involved. This creates a potential conflict of interest requiring retention of private counsel to represent the employee. Moreover, it is unduly harsh to place federal employees who work with tax information regularly in the position of risking financial ruin daily for any mistaken disclosure.

Of course, federal employees would continue to be subject to administrative sanctions, including dismissal, for any negligent disclosure as well as criminal prosecution for any willful, corrupt or malicious abuse of tax information.

Conforming Amendment

Section 9. The final section of the compromise bill is a technical conforming amendment to make the remaining provisions of §6103 consistent with the new two-part definition of tax-related data held by IRS.

Senator GRASSLEY. You have time for questions, I hope.

Senator NUNN. Surely.

Senator GRASSLEY. Senator Baucus had to excuse himself, and he will not be back, but he did ask that I ask you for him where your bill disagrees and is different from the administration bill?

Senator NUNN. I can't answer that now because I have not seen the administration bill. I have not had the chance to study it. It is my impression that they are very close, but I really can't give you a good answer to that.

Senator GRASSLEY. If you would like to, for Senator Baucus' benefit, submit something in writing for the record.

Senator NUNN. We will submit it for the record. My impression is that the two bills are very close.

Senator GRASSLEY. I will also announce, then, for the benefit of anybody, that we are going to keep the record open to receive any appropriate material on this legislation.

Why is it necessary to create new definitions for returns and for return information; won't this create problems with other parts of section 6103?

Senator NUNN. I would say, whatever problems are created, and I would never underestimate our ability to create new problems with solutions because that is the history of legislation. But whatever problems are created would pale in comparison to the problems of the current definitions. That is one of the biggest problems that flows through the whole problem area.

These definitions, first of all, are very sweeping. I have already given you one example of having the IRS digging out a trash can outdoors, and DEA could not even get that information. It was deemed to be taxpayer information, which to me is incredible, but that was the way it was interpreted.

So the definitional part of the law is uninterpretable. It is vague. It's all inclusive. It dramatically needs clarification.

We had the Chief Counsel of the Internal Revenue Service for one of our hearings, and we asked him to give us his interpretation of several different hypotheticals under the existing law on how they fit in the definitions, and he could not do it.

Senator GRASSLEY. If judges already use the standards you have in your bill for granting ex parte court orders, why is it necessary to include them in your bill?

Senator NUNN. Mr. Chairman, let me add to the last question, and then we could come back to that one.

If the definitions cause problems in the 6103 area, you could isolate our definitions to the non-tax crime section, and my staff will be glad to work with yours on that.

Senator GRASSLEY. All right.

Senator NUNN. We will be glad to try to mitigate any confusion caused in here.

If you don't mind repeating your last question.

Senator GRASSLEY. If judges already use the standards you have in your bill for granting ex parte orders, why is it necessary to include them in your bill?

Senator NUNN. For clarification purposes, and because different courts have different definitions. The law itself is sufficiently clear, even though some courts have used common sense and have applied a degree of common sense to the law, which I welcome. The law itself causes a great deal of confusion, and in effect the law intimidates a great number of people who would otherwise use the provisions of the law, if they knew what the court decisions were, but many times they don't.

Senator **Grassley**. Disclosing an individual's tax return to State and local governments troubles me. Many law enforcement officials in small communities could divulge the information from an individual's income tax return, and it might at some later time be a source of embarrassment to that person. Obviously, this sort of disclosure would be very discrete, but incidents do occur. What in your bill could prevent this from happening?

Senator **Nunn**. We have sanctions against any individual who improperly discloses any of this information, or in any way abuses the information. There would be two court orders that would be required.

First, the Justice Department, on any taxpayer-supplied information, would have to get a court order in order to secure that information. Second, before they turned it over to any State or local official, there would have to be another court order. So going through two procedures, we think is sufficient safeguard.

We cannot guarantee in any law against human fallibility, and nothing in here does that. But there are continued provisions for punishment, and we think we have, with the two court orders required, very stringent safeguards here.

Senator **Grassley**. What justification is there for ever disclosing an individual's tax return to an international entity?

Your bill provides for broad disclosure of return information to international authorities. If the problem we are concerned with is drug trafficking, shouldn't we just limit the scope of your bill to disclosing illegal narcotics trafficking?

Senator **Nunn**. Mr. Chairman, if that is the wish of the committee in that particular area, on that subsection about foreign countries, I would certainly go along with that.

First of all, you would have to have a treaty. Secondly, there would have to be reciprocity with the other country before this provision would be enacted. Third, it would only be in matters of great international concern.

I can visualize matters in the non-narcotics area, in organized crime, and so forth, where it would come into play, but if the committee wishes to limit it to narcotics, I think it would be a step forward.

We have got to get foreign countries to cooperate with us in the narcotics area. If we don't improve that cooperation, we are not going to make a lot of progress. This would encourage them to do so, but it would only apply if there was reciprocity, and we had the same provisions, for instance, with a citizen of Colombia. That would make a tremendous amount of difference in many of our prosecutions.

Senator **Grassley**. My last question deals with the subject you discuss in your written testimony in regard to the difference between corporations with two or less shareholders, as opposed to those with three or more.

What is the significance of two rather than three shareholders, and is there some evidence that corporations with three or more shareholders engage in more criminal activity than those companies owned by two or fewer people?

Senator NUNN. Mr. Chairman, that is a good question. There is no good answer to that. There is no difference in two and three. We are simply trying to define small. Two is obviously small. I think that three is small, too. You might want to say 10, or you might want to say 25. I would certainly be willing to accept a reasonable amendment in this area.

I think the point is that large corporations don't have the expectation of privacy under any of our other laws that the small corporations have. But there is nothing magic about the number. I think myself it is too small. Defining a small corporation is a constant problem in the Small Business Committee. The only realistic definition I have ever heard is that a small corporation is one that does not have a fully engaged, full-time paid lobbiest representing them in Washington. [General laughter.]

Senator GRASSLEY. Thank you, Senator Nunn, for your kind attention to our questions, your expert testimony, and your leadership in this area. Obviously, you are tackling a big problem, and I hope that you are successful.

Senator NUNN. Thank you very much, Mr. Chairman.

Senator Baucus had asked another witness questions about how many cases, if I could just volunteer some information.

Senator GRASSLEY. Yes.

Senator NUNN. We had a very brief survey done for us by DEA and FBI. It was done over a weekend, and they only had a very limited amount of time. We asked them the question: In how many cases was the IRS impeded in cooperating with DEA and FBI that they knew about. The catch here is, FBI and DEA don't know about most cases, because they don't ever know that the information exists, like the examples I have given you.

So in order to get good information, you have to get the IRS to give you that answer, too. Frankly, they never have been willing, with their past reluctance to support this kind of legislation, to provide that kind of information to us. But I think this committee, with its leverage, could probably get that from them, particularly since they have obviously changed direction now.

The answer to the question we got was that there had been 70 separate cases that were documented by FBI and DEA in which the Tax Reform Act had severely impeded and/or completely halted certain criminal investigations. These investigations involved espionage, child pornography, drug smuggling, land fraud, public corruption, oil fraud, and GSA fraud. But that was a very brief survey, and perhaps it could be updated.

I would encourage you to get more updated information from IRS. That is an area where they would have the best information.

Senator GRASSLEY. Thank you, Senator.

Senator NUNN. Thank you.

Senator GRASSLEY. It is now my pleasure to call the person on the list, Mr William J. Anderson, Director of General Government Division, General Accounting Office.

Would you like to introduce your staff members, Mr. Anderson?

STATEMENT OF WILLIAM J. ANDERSON, DIRECTOR OF GENERAL GOVERNMENT DIVISION, GENERAL ACCOUNTING OFFICE, ACCOMPANIED BY ANDREA KOLE, ATTORNEY; AND JOHN GUNNER, AUDIT MANAGER, GENERAL ACCOUNTING OFFICE

Mr. **Anderson**. Good afternoon, Mr. Chairman.

I am accompanied today by, on my left, Andrea Kole, an attorney in our Office of General Counsel, an expert in tax matters. On my right is John Gunner, the audit manager who has been responsible for GAO's work in the area involving section 6103 and disclosure of tax information generally.

I do have a detailed statement which I would like inserted for the record, sir, and then I have a brief summary I would like to present.

Senator **Grassley**. Thank you very much, and your statement will be printed in the record in toto.

Mr. **Anderson**. Thank you, sir.

I think as a result of all the work it has done, GAO is persuaded that there is a need to revise section 6103 to ease access to the information that IRS has by law enforcement agencies. We don't expect that this is going to result in any great revolution regarding apprehension of criminals, but it will help. It is an unwinnable battle apparently, but we do believe there are some gains to be had.

I would like to briefly cover the problems that we see that presently flow from the language of 6103.

First, Justice doesn't know what IRS is about. There is a relationship here to between Justice's policies on successive Federal prosecution and dual prosecution whereby cases that IRS develops will at the last minute not be prosecuted, deferring instead to a drug prosecution.

Next, U.S. attorneys are making limited use of the access provisions because of the complications involved. The figure was cited earlier that in 1975 we had 1,800 requests, and recently we are averaging an amount of 274 a year.

Next, IRS cannot initiate disclosure of information it has about nontax crimes that was provided by the taxpayer or his agents. For example, one we cite in our detailed statement, a taxpayer had actually shown narcotics to be his occupation in showing income of $200,000 as a result of trafficking in these substances, and yet IRS was prohibited by the law from disclosing that information to law enforcement authorities. Whether in fact the law was violated in some fashion, and whether in some manner the information was communicated, we cannot speak to.

Finally, information obtained by Justice attorneys under 6103 cannot be used for related civil proceedings.

As I said before, we believe that S. 732 will help, but we do believe that it needs to be modified in several respects.

First, we believe that similar protections should be afforded to all taxpayers. I think you hit on that very precisely here with Senator Nunn regarding what is magic about one- or two-person partnerships, and corporations. We believe that corporations and partnerships should be afforded the same protections as individuals.

Next, regarding the limiting of authority to seek access and relaxing of criteria for getting court approval, we believe that this should be modified to recognize that access should not be sought if the information can be obtained more readily in some other fashion.

In other words, we see a need for recognition that Justice shouldn't have carte blanche entree, and if in fact the information can be obtained elsewhere, Justice need not go to IRS to get it.

Next, we disagree with extending access to inspectors general, and in fact even retaining access for heads of agencies. We believe that all these requests should be funneled through the Department of Justice. For one thing, this would certainly insure improved coordination with the Department, and improve awareness of what is going on across Government.

Next, we believe that there should be some clarification with respect to the language in the bill where IRS is obligated to disclose third-party information to law enforcement agencies. I think that Commissioner Egger touched on this briefly.

The point being that if obligated were interpreted to mean that IRS should on some regular basis scan their files for possible information, this could impose quite a burden on the Service. If, on the other hand, they run across this information in the course of their regular tax administration activities, there is no problem at all. We believe the committee should consider clarifying that.

There is one omission in the bill that we believe should be addressed; namely, IRS would still lack the authority to unilaterally disclose privileged information, that is, return and taxpayer return information concerning nontax crimes that it has in its files, absent a request from a law enforcement agency that has been successful in obtaining an ex parte order.

We believe that IRS, in such instances, should be empowered to obtain an ex parte court order on its own initiative, and to transfer the information to the proper authorities.

Concerning the emergency circumstances section of the bill, we believe that the IRS should be required to include a specific disclaimer on its inability to obtain an ex parte order, such as I have just described, in order to provide information under the emergency provision.

We also have a problem with the open-ended language which essentially states that no portion of the disclosure provisions are designed to prevent IRS from assisting other agencies. This is one broad, seemingly catch-all provision in the bill that perhaps could be interpreted to override all other provisions in it. We believe it should be clarified.

Finally, we believe that IRS should be authorized to discuss its own tax cases with Justice before referring them for prosecution. Presently, the lack of such authority probably contributes to the fairly high declination rate that IRS experiences with the cases that it submits to Justice.

That concludes my summary, sir. We will try to answer any questions you have.

[Statement of Mr. Anderson follows:]

UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C.

FOR RELEASE ON DELIVERY
EXPECTED AT 2:00 P.M. EST
MONDAY, NOVEMBER 9, 1981

STATEMENT OF
WILLIAM J. ANDERSON, DIRECTOR
GENERAL GOVERNMENT DIVISION
BEFORE THE
SUBCOMMITTEE ON OVERSIGHT OF THE INTERNAL REVENUE SERVICE
SENATE COMMITTEE ON FINANCE
ON THE EFFECTS OF THE 1976 TAX REFORM ACT'S DISCLOSURE PROVISIONS ON LAW ENFORCEMENT ACTIVITIES

Mr. Chairman and Members of the Subcommittee:

We are pleased to be here today to discuss an issue which continues to generate concern and controversy--whether tax disclosure restrictions prevent cooperation and coordination between the Internal Revenue Service (IRS) and other law enforcement agencies. Our testimony is based on extensive work that we have done at various times over the last few years on the effects of the disclosure provisions on Federal law enforcement activities.

In March 1979, we issued a report to the Joint Committee on Taxation entitled "Disclosure and Summons Provisions of 1976

Tax Reform Act--Privacy Gains With Unknown Law Enforcement Effects" (GGD-78-110). In that report, we pointed out that the disclosure provisions had afforded taxpayers increased privacy over information they provide IRS but had adversely affected IRS' ability to coordinate with other members of the law enforcement community.

In December 1979, we testified before the Permanent Subcommittee on Investigations, Senate Committee on Governmental Affairs, on IRS' efforts to combat narcotics traffickers. We identified the disclosure provisions as a factor limiting IRS' involvement. We stated that changes were needed to the disclosure provisions, particularly with respect to allowing IRS to initiate disclosure of information about non-tax crimes.

In April 1980, we testified before the Senate Appropriations Subcommittee on Treasury, Postal Service, and General Government on changes needed to strengthen Federal efforts to combat narcotics traffickers. We proposed various administrative actions that IRS could take to expedite authorized disclosures of tax information to other agencies. However, we reemphasized the need for legislative changes to the disclosure provisions to enhance cooperation and coordination between IRS and law enforcement agencies.

Shortly thereafter, hearings were scheduled on a series of legislative proposals to amend the disclosure provisions. The proposals--S.2402, S.2404, and S.2405--were developed and introduced by the Chairman of the Permanent Subcommittee on Investigations as a result of the December 1979 hearings. In June 1980, we issued a report 1/ and testified on the results of our analysis of the proposed Senate bills. We expressed support for the overall thrust of the bills. However, we called for substantial modifications to S.2402 to accommodate privacy concerns and to authorize a more effective disclosure mechanism. Following the June 1980 hearings, extensive revisions were made to S.2402. Then, in March 1981, S.2402, S.2404, and S.2405 were consolidated and reintroduced in this Congress as S.732.

For several years, we have supported the need for changes to the disclosure law to improve the effectiveness of law enforcement. In doing so, we have consistently maintained that it is essential to strike a proper balance between legitimate privacy concerns and equally legitimate law enforcement information needs. In this regard, our work in the disclosure area has been guided by two basic principles. First, IRS is not primarily a criminal law enforcement agency. Rather, its primary mission is to collect taxes and to encourage and achieve the highest possible degree of voluntary compliance with the tax laws. Second, taxpayers who supply information to IRS have a basic right to privacy with respect to that information. Such information should be subject to disclosure for non-tax purposes only when society has a compelling interest which outweighs individual privacy concerns.

With those principles in mind, I would now like to describe some of the specific problems caused by the disclosure provisions

---

1/"Disclosure and Summons Provisions of 1976 Tax Reform Act--An Analysis of Proposed Legislative Changes" (GGD-80-76, June 17, 1980).

and highlight our suggestions for dealing with these problems through legislation.

DISCLOSURE PROVISIONS HAVE REDUCED COORDINATION BETWEEN IRS AND OTHER LAW ENFORCEMENT AGENCIES

In enacting the disclosure provisions, the Congress clearly signaled its intention that IRS concern itself primarily with its basic mission--encouraging and achieving the highest possible degree of voluntary compliance with the tax laws. On the other hand, the Congress did not intend to put a halt to appropriate IRS participation in joint Federal efforts to combat crime. Rather, it sought to place tight controls on such IRS activities in an effort to prevent infringements on taxpayers' privacy rights. Since their enactment over 5 years ago, however, the disclosure provisions have affected cooperation and coordination between IRS and other law enforcement agencies in four major ways.

First, IRS' ability to coordinate effectively with Justice Department attorneys and other law enforcement agencies has been reduced. Coordination between IRS and the Department of Justice is essential to efficient Federal law enforcement. U.S. attorneys, for example, are responsible for prosecuting criminal tax cases and other criminal cases referred to them by other agencies. Because they often are aware of the investigative efforts of numerous agencies, U.S. attorneys can coordinate Federal law enforcement efforts, help prevent duplicative investigations, provide investigative guidance, and otherwise assist Federal law enforcement officials in developing successful cases. Likewise, Strike

Force attorneys are responsible for coordinating the efforts of various Federal law enforcement agencies against organized crime.

Under the disclosure provisions, however, U.S. attorneys and Strike Force attorneys often cannot coordinate IRS' criminal tax investigations with the non-tax investigations conducted by other Federal agencies. This is because the provisions, as interpreted by IRS, generally prohibit the Service from discussing the specifics of contemplated or ongoing investigations with Justice attorneys until cases have been formally referred to Justice for prosecution.

Thus, because Justice attorneys often do not know the identity of taxpayers under investigation by IRS, they cannot fully carry out their prescribed duties. For example, Justice attorneys have prosecuted individuals on non-tax criminal charges without knowing about ongoing tax investigations on the same individuals. In such instances, the attorneys lose the added advantage that the tax violations might have brought to their cases. In addition, such prosecutions render IRS investigations meaningless because Justice's "dual prosecution" policy requires that all offenses arising from a single transaction, such as narcotics trafficking and evading taxes on the ensuing profits, should be tried together. That policy recognizes the difficulties a Justice attorney would face in seeking to secure a second conviction on the basis of essentially the same set of facts. The following examples illustrate the dual prosecution problem.

--An individual who had failed to report at least $150,000 during a 2-year period was sentenced to

1 year in prison on a narcotics misdemeanor. IRS attorneys did not refer the criminal tax case on this individual to Justice because he already had been incarcerated.

—In another case, the Department of Justice declined to prosecute a Drug Enforcement Administration class I violator on criminal tax charges because he pled guilty to a non-tax felony violation carrying a maximum sentence of 5 years in prison. Subsequently, the individual was sentenced to 5 years probation. IRS' investigation thus proved useless from a criminal tax standpoint.

The disclosure provisions also hinder Justice attorneys in providing investigative guidance to IRS special agents before cases are formally recommended for prosecution. Finally, the attorneys cannot effectively coordinate ongoing IRS investigations with investigations being carried out by other Federal agencies.

Second, since the disclosure provisions were enacted, Justice attorneys have made little attempt under these provisions to obtain tax information for use in non-tax criminal cases, even when they have a bonafide need for and are authorized to obtain such information. In the 1976 Tax Reform Act, the Congress provided two means through which Federal agencies, such as the Justice Department, could gain access to tax information.

—To obtain information supplied to IRS by a taxpayer, an agency head must obtain a court order.

--To obtain information supplied to IRS by third parties, an agency head must file a written request for the information with IRS.

Since January 1, 1977, the effective date for the disclosure provisions, we have closely monitored the utility of these two access mechanisms. The Congress intended U.S. attorneys and Strike Force attorneys to be the prime users of tax information for non-tax criminal purposes. From the outset, however, definitional problems, misunderstandings, and differences over legal interpretations caused serious problems. Moreover, many Justice attorneys were of the view that it would be difficult to meet the criteria to obtain a court order and that the administrative disclosure process would be burdensome and time-consuming. These Justice attorneys thus decided that they would carry out their duties as well as they could without tax information. As a result, requests for tax information declined precipitously. Justice reported, for example, that its attorneys had made 1,816 requests for tax information in 1975. In contrast, IRS statistics indicate that fewer than 250 requests were received, on the average, in 1977, 1978, and 1979--the first 3 years the disclosure provisions were in effect.

In response to continuing congressional inquiries, however, Justice and IRS took a number of administrative actions in 1980 to facilitate the disclosure process under existing law. For example, IRS decentralized the authority to disclose tax information in response to court orders and written requests. Concurrently, Justice developed a comprehensive set of guidelines for

U.S. attorneys. The guidelines sought to clarify disclosure criteria, simplify disclosure paperwork, and otherwise encourage use of the access mechanisms authorized by existing law. These actions were successful in removing some of the burden associated with the process and improving timeliness. However, on the basis of a recent sampling of Justice attorneys' views, we determined that the administrative actions taken had not succeeded in changing the attorneys' views concerning the access mechanisms. As a result, the attorneys say they still make little use of tax information for non-tax criminal investigative and prosecutive purposes, despite congressional recognition of the propriety of, and the need for, such uses of tax information.

Third, IRS cannot self-initiate the disclosure of information about certain non-tax crimes. For example, in one case we reviewed, a taxpayer blatantly listed "narcotics" as his occupation on his tax return and, over a 2-year period, reported well over $200,000 in revenues from the "sale of controlled substances." Because the information was reported on a tax return, IRS could not refer the matter to the Justice Department.

Fourth, current law authorizes Justice attorneys, through court order or written request, to obtain tax information for use in non-tax criminal cases. However, information the attorneys obtain from IRS through these processes cannot be used in civil proceedings directly related to the criminal investigation. For example, under Title 21, Section 881 of the U.S. Code, Justice attorneys may seek civil forfeiture of vehicles, equipment, cash, and other items used in connection with narcotics transactions. In some instances, a Justice attorney investigating a drug trafficker for criminal violations will seek tax information from IRS. If, however, the attorney subsequently decides to pursue the trafficker under Section 881, he cannot use the tax information obtained from IRS as part of the civil case.

SENATE BILL 732, WITH MODIFICATIONS, WOULD HELP RESOLVE COORDINATION PROBLEMS

After almost 5 years of experience with the disclosure provisions, it is apparent that coordination and cooperation between IRS and law enforcement agencies have been adversely affected. Thus, while some administrative actions have been taken to enhance law enforcement efforts, legislative changes also are needed. However, there is no need to completely revamp existing law; instead, refinements can be made to resolve coordination problems while still protecting important privacy rights.

Although refinements to the disclosure provisions could be accomplished in various ways, an existing proposal--Senate bill 732--already contains many of the needed refinements. That bill can be modified in light of the basic principles mentioned earlier in my testimony to provide a more effective disclosure process and more balance between privacy and law enforcement. I would now like to summarize our proposed modifications, which are discussed in detail in the appendix to my prepared statement.

Our first modification centers on changes S.732 would make to categories of tax information. Present law defines three categories of tax information--a "return," "return information," and "taxpayer return information." These categories have proven somewhat confusing and need to be simplified. S.732 seeks to accomplish that objective by dividing tax information into two mutually exclusive categories--"return information" and "nonreturn information."

Although we support the concept of simplified tax information categories, S.732's definition of "return information" is too narrow. Under S.732, information supplied to IRS by any business entity composed of more than two persons would receive less protection than that afforded to information supplied IRS by individual taxpayers. In our view, any tax return information supplied to IRS by any taxpayer ought to be included within S.732's "return information" category and should be afforded the higher level of protection that category warrants.

Second, S.732 would vest the authority to seek access to tax information via court order in a limited number of Justice Department attorneys. It would also relax the criteria an attorney must meet to gain the court's approval for such access. These changes would facilitate appropriate use of tax information, thus enhancing Federal efforts to combat crime. Decentralization should facilitate and improve timeliness of the disclosure process. Relaxing the court order criteria would encourage, rather than discourage, use of this access mechanism where there is a bonafide need for tax information. From a privacy perspective, however, the criteria set forth in S.732 could be modified to recognize that Justice attorneys should not seek access to tax information via court order if, in fact, the information can be more readily obtained elsewhere.

Third, S.732 would extend the authority to seek access to tax information via written request to additional Justice attorneys, the heads of Federal agencies, and Inspectors General. It also would slightly relax the criteria requestors must meet in order to be granted access to tax information. While we agree with the intent of this provision, we see no need for agency heads and Inspectors General to have the authority to seek access via written request. If that authority were limited to Justice attorneys, agency heads and Inspectors General could still gain access to needed tax information by coordinating effectively with Justice. We suggest that S.732 be modified accordingly.

Fourth, present law authorizes IRS to disclose information concerning non-tax crimes it obtains from third parties not acting on the taxpayer's behalf. S.732 would legally obligate, rather than authorize, IRS to disclose third-party information to other Federal law enforcement agencies. If interpreted as requiring IRS to regularly search its files for evidence of non-tax crimes, this provision could cause IRS to become involved in intelligence gathering to the detriment of its primary responsibilities. While we do not believe this to be the intent, the scope of IRS' responsibilities under this provision needs clarification.

On a related matter, under present law, when information provided by a taxpayer indicates commission of a non-tax crime by that person, IRS cannot report the violation to Justice. S.732 would not resolve this problem. Therefore, we suggest that it be modified so IRS can apply for an *ex parte* court order to disclose such information. The court could then determine whether the information is material and relevant to a violation of criminal law, and whether it ought to be disclosed.

Fifth, present law provides no specific authorization for disclosure under "emergency circumstances." S.732 seeks to resolve this problem by authorizing IRS to disclose to other Federal agencies, without a court order, necessary information concerning (1) imminent danger to persons or property or (2) flight from prosecution. We agree with the intent of this provision. However, the provision could be more narrowly drawn by keying it to IRS' inability to obtain a court order, as we suggested earlier, in sufficient time to prevent the emergency from occurring.

Sixth, S.732 explicitly states that no portion of the disclosure provisions is designed to prevent IRS from assisting other agencies in joint tax and non-tax investigations. The intent of this provision is unclear and, in the extreme, some might view it as completely overriding most other disclosure restrictions. Therefore, it needs to be clarified.

Finally, consideration also should be given to dealing with another problem which S.732 does not address. Specifically, under current law, IRS considers itself precluded from discussing investigative targets with Justice attorneys until such time as completed tax cases are referred for prosecution. As discussed earlier, this has caused considerable coordination problems between IRS and Justice. S.732 should address this problem.

- - - -

In summary, the disclosure provisions have afforded taxpayers increased privacy over information they provide IRS. The provisions have also affected coordination between IRS and other agencies and thus have had an adverse effect on law enforcement efforts. The extent of that effect is difficult to measure and, indeed, may not be measurable. However, one fact is clear--despite administrative actions aimed at facilitating coordination and cooperation under existing law, problems persist. Thus, to improve the effectiveness of Federal law enforcement efforts, legislative changes are needed to facilitate cooperation between IRS and other agencies. The Congress could accommodate this need and still maintain essential privacy controls by enacting a modified version of S.732.

This concludes my prepared statement. We would be pleased to respond to any questions.

COMPARATIVE ANALYSIS OF 26 U.S.C. §§6103, 7213, and 7217

WITH

SENATE BILL 732

TAX DISCLOSURE PROVISIONS: COMPARISON OF 26 U.S.C. §6103 AND S.732 1/

CATEGORIES OF TAX INFORMATION

26 U.S.C. §6103	S.732
Existing law divides information into three categories: return, return information, and taxpayer return information.	Proposal, by definition, divides information into return information and nonreturn information, eliminating the category of taxpayer return information.
(b) Definitions	(b) Definitions
(1) Return--any document the taxpayer is required by law to file, including information returns, declarations of estimated tax, claims for refund, and any schedules and attachments.	(1) Return information--(a) all documents within existing category of "return" and (b) any information provided to IRS by or on behalf of an individual taxpayer.
(2) Return information--(a) all information on the return; (b) all information IRS has concerning the return, (e.g., whether the return is being audited;) (c) all data received or collected by IRS relating to the return and determination of tax liability; and (d) any background or written document on the determination not open for public inspection.	(2) Nonreturn information--all other information IRS has relating to the return and tax liability.
By definition, return information does not include data in a form which cannot be associated with, or otherwise identify, directly or indirectly, a particular taxpayer.	
	Proposal adds a new definition:
(3) Taxpayer return information--return information (as in (2)) which is filed with or furnished to IRS by or on behalf of the taxpayer.	(3) Individual taxpayer--includes any individual taxpayer and small corporation, partnership, association, union or other entity with no more than two members.

1/This analysis is limited to the impact of the major provisions of S.732.

GAO Comments

Under present law, information supplied to IRS by a taxpayer, or anyone acting on his behalf, generally is disclosed only pursuant to court order. This court order requirement applies to information supplied by corporate as well as individual taxpayers. Under S.732, the category of protected tax information would include: (1) all tax returns, and (2) any information supplied IRS by, or on behalf of, individual taxpayers and one- or two-person corporations, partnerships, or similar business entities. Information supplied IRS by any business entity composed of more than two persons could be disclosed upon the written request of certain Government officials. We believe that information supplied to IRS by business entities, regardless of size, should remain on the same footing as information supplied by individual taxpayers. We would recommend, therefore, that the bill not draw a distinction between individual taxpayers and corporations, partnerships, associations, unions, or similar business entities.

Several factors underlie the rationale for this recommendation. First, the basis for distinguishing between two- and three-person business entities has not been established. Second, recent court opinions, including those of the Supreme Court, do not support the proposition that corporations, unlike individuals, do not enjoy constitutional protections. And third, information supplied to IRS by persons in support of a corporate return may disclose information about individual taxpayers. In other words, in disclosing business records, it may be easy to identify the individual taxpayer involved. This is true regardless of the size of the business entity involved. Finally, the matter of access to tax information in general should be placed in perspective. S.732's amendments to section 6103 would facilitate access to all tax information. This would be accomplished under S.732 primarily by lessening the standards for obtaining court orders and decentralizing the authority to request tax information. Corporate records could be disclosed under these mechanisms as readily as individual records.

The importance of S.732's definitional section cannot be overstated since the definitional categories ultimately determine the degree of privacy afforded the taxpayer. Under present law, the statutory definitions are somewhat ambiguous and need clarification--a point recognized by S.732. One alternative way to clarify the categories of tax information, and at the same time provide comparable protection to corporate and individual taxpayers, would be to amend section 6103 to provide for only two categories of tax information: (1) return--to include all tax returns and information supplied to IRS by all taxpayers or anyone acting on their behalf, and (2) return information--to include all other information IRS has with respect to the taxpayer. From a technical standpoint, we note that use of the terms "return" and "return information", in lieu of S.732's terms "return information" and "nonreturn information," would minimize the need to make conforming amendments to those provisions in section 6103 which are unrelated to disclosures for law enforcement purposes, such as disclosures to the Census Bureau.

GAO Suggested Statutory Language

Paragraph (1) of subsection (b), section 6103 of title 26, United States Code, should be amended to read as follows:

(1) Return
The term "return" means:
(A) Any tax or information return, declaration of estimated tax, or claim for refund required by, or provided for or permitted under, the provisions of this title which is filed with the Secretary by, on behalf of, or with respect to any person, and any amendment or supplement thereto, including supporting schedules, attachments, or lists which are supplemental to, or part of, the return so filed, and
(B) Any information provided by or on behalf of the taxpayer to whom such information relates, including
  (i) the nature, source, or amount of the taxpayer's income, payments, receipts, deductions, exemptions, credits, assets, liabilities, net worth, tax liability, tax withheld, deficiencies, over-assessments, or tax payments, and
  (ii) any part of any written determination, or any background file document relating to such written determination (as such terms are defined in section 6110(b)) which is not open to public inspection under section 6110,
But such term does not include data in a form which cannot be associated with, or otherwise identify, directly or indirectly, a particular taxpayer.

Paragraph (2) of subsection (b), section 6103 of title 26, United States Code, should be amended to read as follows:

(2) Return information The term "return information" means any information which the Secretary collects, obtains, or receives (including whether a return was filed and whether the taxpayer's return was, is being, or will be examined or subject to other investigation or processing), or any part of any written determination or any background file document relating to such written determination which is not a return as defined in paragraph (1).

But such term does not include data in a form which cannot be associated with, or otherwise identify, directly or indirectly, a particular taxpayer.

Paragraph (3) of subsection (b), section 6103 of title 26, United States Code, the category "taxpayer return information," should be repealed.

COURT-ORDERED DISCLOSURES

26 U.S.C. §6103	S.732
(i) Disclosure for Administration of Federal Laws Not Relating to Tax Administration	(i) Disclosure for Administration of Federal Laws Not Relating to Tax Administration
(1) Non-tax criminal investigation:	(1) Non-tax criminal investigation:
(A) Requires ex parte court order for disclosure of return or taxpayer return information to law enforcement agencies.	(A) Requires ex parte order for disclosure of "return information."
(B) Application for order by head of Federal agency involved in law enforcement or in case of Department of Justice, the Attorney General, Deputy Attorney General, or Assistant Attorney General.	(B) Application for order by Attorney General, Deputy Attorney General, Assistant Attorney General, U.S. Attorney, or Attorney in charge of organized crime strike force.
Ex parte order may be issued if	Ex parte order may be issued if
(i) on the basis of reliable information, there is reasonable cause to believe a crime has been committed;	(i) on the basis of reliable information, there is reasonable cause to believe a crime has been, or is being, committed;
(ii) there is reason to believe that the return is probative; and	(ii) information is sought exclusively for use in Federal criminal investigation; and there is
(iii) information cannot reasonably be obtained from another source.	(iii) reasonable cause to believe information sought is relevant.

GAO Comments

Under existing law, "return" and "taxpayer return information" can be disclosed only by court order, applied for by the heads of Federal law enforcement agencies. Taxpayer return information includes any information concerning the return supplied to IRS by either the taxpayer or anyone acting on the taxpayer's behalf. Under this provision, for example, an accountant's work papers provided to IRS during an audit can be disclosed for non-tax purposes only by court order.

Under S.732, ex parte orders would be required for disclosure of "return information." As a general proposition, all other information, including the records of three or more person business entities, would be disclosed on the request of certain Government officials. In our view, information supplied to IRS by any taxpayer or his agents should be disclosed only pursuant to a court order. (See p. I-2).

S.732 would amend the criteria for obtaining a court order. According to Justice officials, under the existing criteria, law enforcement agencies are caught in a Catch 22 position. To obtain the order, they must show that there is reason to believe that the information sought from IRS is probative. The Department of Justice has testified to considerable difficulty in meeting this standard in that often it cannot show that the information is probative until it actually has the requested tax information. S.732 responds to this by amending section 6103(i)(1) to require the Justice Department to show that the information sought from IRS is relevant, rather than probative. While we recognize that the standard of "relevancy" is intended to be less demanding than the "probative" test of present law, we would recommend the Committee provide interpretive guidance about how the criteria proposed in S.732 would differ in application from the requirement of current law.

S.732 does away with the requirement that, to obtain a court order, the agency seeking disclosure from IRS first ascertain that the information is not available from another source. In recognition of IRS' primary responsibility to administer the tax laws and collect the revenue, the Committee could consider refining the bill to recognize that if the law enforcement agency can obtain the information from another source in a timely manner, and without prejudicing enforcement, there is no persuasive reason why judicial process should be invoked to compel disclosure by IRS.

Under existing law, the authority to request tax information for law enforcement purposes, either by court order or written request, generally lies with the head of any Federal agency that enforces Federal criminal laws not involving tax administration. S.732 would vest the authority to request a court order in a limited number of Government attorneys within the Department of Justice. The heads of Federal investigative agencies could no longer independently request tax information. We agree with this proposal. Restricting this authority to Justice officials would promote the coordination between IRS and Justice which is essential to efficient Federal law enforcement. In this manner, Justice could help prevent duplicative investigations, provide investigative guidance, and otherwise assist Federal law enforcement officials in developing successful cases. And, by placing this authority in Justice, a mechanism is provided to insure that requests made under both sections 6103(i)(1) and (i)(2) meet the applicable statutory requirements.

Also, when information obtained under §6103(i)(1) is disclosed, we see no need for the requirement that Justice submit a written request for disclosure of less protected "return information" under §6103(i)(2). This is because in obtaining §6103(i)(1) information, Justice has already met a more stringent criteria than that contained in §6103(i)(2). (See p. I-7).

DISCLOSING NONRETURN INFORMATION

26 U.S.C. §6103	S.732
(i)(2) Disclosure of return information other than taxpayer return information by written request of agency heads directly engaged in criminal law enforcement.	(i)(2) Disclosure of nonreturn information on written request of agency heads and Inspectors General, and in the case of the Department of Justice, the Attorney General or his designee.
Such request shall include (i) name and address of the taxpayer, (ii) relevant taxable periods, (iii) statutory authority for the investigation or proceeding, and (iv) specific reason or reasons why such disclosure is or may be material to the proceeding or investigation.	Such request shall include (i) name and address of the taxpayer, (ii) relevant taxable periods, (iii) statutory authority for the investigation or proceeding, and (iv) allegations of criminal conduct giving rise to the proceeding or investigation.
Name and address of taxpayer disclosed pursuant to written request.	Name, address, social security number of taxpayer, whether a taxpayer filed a return, and whether there is or has been a criminal investigation of taxpayer disclosed pursuant to written request.

GAO Comments

Under existing law, information which can be disclosed on written request of an agency head is limited to information which is not considered taxpayer return information. S.732 would allow all "nonreturn information" to be disclosed upon written request of certain Government officials. As discussed on page I-2, the category of protected information under S.732 seems too narrow. It would allow Government officials to gain access by written request to some categories of information that, in our opinion, should be protected and disclosed only via court order.

Under present law, the written request must state the specific reason why disclosure is or may be material to the criminal investigation. S.732 amends this to simply require an allegation of criminal conduct giving rise to the proceeding or investigation. This amendment should alleviate the so-called Catch 22 situation, discussed on page I-5, in the case of written requests.

We do not agree with the proposal in S.732 to allow all agency heads and Inspectors General to gain access to tax information by written request. This authority should be restricted to Justice officials to insure effective coordination between IRS, Justice, and other Federal agencies. (See p. I-5.) We agree, however, with the provision in S.732 which would allow the Attorney General to delegate this authority to those officials who need access to tax information by written request. Under this proposal, the Attorney General could authorize U.S. attorneys and heads of organized crime strike forces to gain access via written request. Conversely, the Attorney General could subsequently withdraw that authorization as necessary.

Under S.732, Government officials could also find out, by written request, whether a taxpayer filed a return and whether there is or has been a criminal investigation of a taxpayer. This is a needed amendment to section 6103. In the interest of efficiency and economy, law enforcement officials should first know if IRS has potentially useful information on the taxpayer before seeking a court order.

REDISCLOSURE OF TAX INFORMATION

26 U.S.C. §6103	S.732
Tax information obtained under (i)(1) and (i)(2) may be redisclosed to any Federal employee directly engaged in the criminal proceeding.	Explicity authorizes a Government official to redisclose return and nonreturn information obtained either under (i)(1) or (i)(2) to such other Federal government personnel, or witness, he deems necessary to assist him during the criminal proceeding.

GAO Comments

S.732 would make clear that Government officials are authorized to redisclose return and nonreturn information to those necessarily involved in the criminal investigation, including prosecutive witnesses. We agree with this proposal. For example, it is sometimes necessary for prosecutors to disclose evidence to a witness during an investigation or in preparation for a criminal proceeding. We would recommend, however, that when Justice makes requests on behalf of other Federal agencies, the authorization be clear that Justice can then redisclose any information obtained under either section 6103(i)(1) or (i)(2) to those agency heads. Also, an accounting should be required for all such redisclosures.

IRS-INITIATED DISCLOSURE OF NON-TAX CRIMINAL INFORMATION

26 U.S.C. §6103	S.732
(i)(3) IRS may disclose information other than taxpayer return information to agency heads where there is evidence that a Federal crime has been committed. Name and address of taxpayer can be disclosed under this provision if return information is available.	(i)(3)(A) Places legal duty on IRS to disclose nonreturn information where there is evidence of a Federal crime. Name of address of taxpayer can also be disclosed under this provision.
No comparable provision.	(B) When IRS makes a prosecutive recommendation to Justice involving a Federal tax crime, any return or nonreturn information evidencing a non-tax Federal crime must also be disclosed. IRS may decline to disclose any information under the above paragraphs if disclosure would identify a confidential informant or seriously impair a civil or criminal tax investigation.

GAO Comments

S.732 places an affirmative legal duty on IRS to provide enforcement agencies information that "may constitute evidence of a violation of Federal criminal laws." The scope of this duty needs clarification. As presently drafted, the bill could contemplate a responsibility, even in the absence of a request, for IRS to regularly review its files for non-tax criminal evidence. Recognizing that IRS' primary responsibility is tax administration, we believe IRS' disclosure obligation should extend to non-tax criminal information it becomes aware of during the normal course of administering the tax laws.

S.732 also authorizes IRS to disclose criminal evidence on non-tax matters to Justice when making prosecutive recommendations in a tax case. This would allow necessary coordination within the Department, providing Justice officials with the needed flexibility to decide how to proceed against a certain individual, and helping to avoid problems stemming from the Department's dual prosecution policy.

We recognize the need expressed in S.732 to enable IRS to provide assistance to law enforcement agencies. Under present law, when IRS uncovers criminal evidence based on taxpayer return information, it lacks authority to report it to the appropriate law enforcement agency. S. 732 does not resolve this problem. Under S.732, IRS would not be authorized to unilaterally inform law enforcement officials when it had criminal evidence based on return information. We suggest, therefore, that the Congress authorize IRS to apply for a court order to disclose protected information. Such a provision would insure that a neutral third party--the judiciary--decides on the disclosure of such information.

GAO Suggested Statutory Language

Paragraph (3) of subsection (i), section 6103 of title 26, United States Code, should be amended to read as follows:

(3) Disclosure of information concerning possible criminal activities.

(A) Information from taxpayer: Upon application by the Secretary, a U.S. District Court may, by *ex parte* order, direct that a return (as defined in section 6103(b)(2)) be disclosed to the head of the appropriate Federal investigative agency if, in the opinion of the court, such information is material and relevant to a violation of Federal criminal law.

(B) Application for order: The application for an *ex parte* court order shall set forth the name of the taxpayer involved; the time period to which the request relates; and the reasons why, in the opinion of the Secretary, the information is material and relevant to a violation of Federal criminal law.

(C) Procedures: A U.S. District Court shall act upon any application for an *ex parte* order within 5 days of the receipt thereof. In the event that the district court denies the application

(i) a motion for reconsideration shall be acted upon not later than 5 days after the receipt of such motion, and

(ii) an appeal shall be disposed of as soon as practicable but not later than 30 days after receipt of appeal.

(D) Duty of the Secretary: The Secretary or his designee shall disclose, to the head of the appropriate Federal investigative agency, information ordered disclosed pursuant to this subsection.

(E) Further Disclosure: The head of the Federal investigative agency may further disclose any information, which has been disclosed to him pursuant to an *ex parte* order, to such other Government personnel or witness as he deems necessary to assist him during or in preparation for any administrative, judicial, or grand jury proceeding or in a criminal investigation which may result in such a proceeding.

(F) Return Information: The Secretary may disclose in writing return information which may constitute evidence of a violation of Federal criminal laws to the extent necessary to apprise the head of the appropriate Federal agency charged with the responsibility for enforcing such laws. For purposes of this subsection, the name and address of the taxpayer shall not be treated as a return if there is return information which may constitute evidence of a violation of Federal criminal laws.

USE OF TAX INFORMATION IN JUDICIAL OR ADMINISTRATIVE PROCEEDINGS

26 U.S.C. §6103	S.732
(i)(4) Any information obtained under (i)(2) or (i)(3) may be entered into evidence in any administrative or judicial proceeding involving a non-tax Federal crime. Information obtained under (i)(1) may be entered into evidence upon the court's finding that the information is probative.	(i)(4) Any information obtained under (i)(1), (i)(2) or (i)(3) may be entered into evidence in any administrative, judicial, or grand jury proceeding involving a non-tax Federal crime or any ancillary civil proceeding by order of the court.

GAO Comments

This provision provides a needed authorization for redisclosure of tax information in connection with civil actions initiated under the civil rights, antitrust, fraud, and organized crime statutes. It also could be invoked for other civil statutes that have a criminal counterpart. It should be recognized, however, that the authorization would not apply to organized crime and antitrust cases where the Government elected to proceed solely on a civil basis, as in a civil forfeiture action under 21 U.S.C.§881. This is because the provision provides no mechanism to transfer tax related information where the judicial action is exclusively civil, and there is no ancillary criminal proceeding or criminal investigation. The Congress may want to consider the desirability of such an authorization.

DISCLOSURE UNDER EMERGENCY CIRCUMSTANCES

26 U.S.C. §6103	S.732
No comparable provision.	Adds a new paragraph (5) to subsection (i) Emergency circumstances: Under emergency circumstances involving an imminent danger of physical injury to any person, serious physical damage to property, or flight from prosecution, IRS may disclose any necessary information to the appropriate Federal agency. IRS must then notify Justice, and Justice must notify the District Court after such disclosure has been made.

GAO Comments

We support the intent of this provision, which provides the Secretary discretionary authority to disclose information in emergency circumstances. We would, however, include the threat to national security in the emergency circumstances identified in the proposal. On the other hand, this provision could be more narrowly drawn and still achieve its intent. As discussed on page I-9, the Secretary should, in our view, be given the authority to seek court-ordered disclosure when IRS uncovers criminal evidence based on a return. In light of this, we suggest that the emergency circumstance disclosure authority of S.732 be explicitly keyed to the Secretary's inability to obtain a court order in sufficient time to prevent physical harm to persons, physical damage to property, harm to national security, or flight from prosecution. We also would suggest expanding this authority to allow disclosure of criminal evidence to appropriate State authorities, since some emergency circumstances, such as murder, would involve State crimes.

GAO Suggested Statutory Language

Subsection (i), section 6103 of title 26, United States Code should be amended to add a new paragraph:

Emergency Circumstances

(A) Under emergency circumstances, the Secretary or his designee may disclose such information, including returns, as is necessary to apprise the appropriate Federal or State authorities having jurisdiction over the offense or matter to which such information relates.

(i) "Emergency circumstances" means circumstances involving an imminent threat of harm to persons, property, or national security, or flight from prosecution, and in which, in the judgment of the Secretary, time is insufficient to obtain an *ex parte* order authorizing disclosure of the information involved.

(B) The Secretary shall maintain standardized records or accountings of all disclosures made under this paragraph.

ASSISTANCE OF IRS IN JOINT TAX/NON-TAX INVESTIGATIONS

26 U.S.C. §6103	S.732
No comparable provision.	Adds a new paragraph (6) to subsection (i) No portion of §6103 precludes or prevents IRS from assisting Federal agencies in joint tax/non-tax criminal investigations.

GAO Comments

We anticipate that IRS and Justice will encounter considerable difficulty administering this provision, and recommend the intended operation of this section be clarified. The precise purpose of the authorization, and the uses to which it may be put, should be defined with greater descriptive clarity. Although the proposal states that nothing in section 6103 shall be construed to preclude or prevent IRS' assistance in joint tax/non-tax criminal investigations it is not clear what type of IRS "assistance" is envisioned, what might qualify as a "joint tax/non-tax" investigation, or whether the authorization is intended to override the disclosure restrictions set forth elsewhere in section 6103. Assuming the existence of a joint investigation, for example, would IRS still be obliged to await a court order or written request to disclose evidence of non-tax offenses in its files? On the other hand, this authorization may be intended simply to encourrage IRS' participation in joint investigations, but only within the framework of the disclosure restrictions prescribed by section 6103. This could be viewed as consistent with other provisions of the bill which, among other matters, modify present law to explicitly authorize IRS to disclose non-tax criminal information to Justice when making a tax case.

In addition, the Congress may want to consider two problems under existing law which are not specifically addressed in S.732. Under §6103(h)(2), which authorizes disclosures to Justice for tax administration purposes, IRS can disclose tax information to Justice when referring a tax case for prosecution. IRS has interpreted this provision as precluding the disclosure of tax information, either in a tax or a joint tax/non-tax criminal case, prior to case referral. Prereferral disclosure in tax cases is essential, however, to insure effective coordination between IRS and Justice in prosecuting criminal tax matters, and to obtain such advice as may be necessary to develop the tax case. In addition, §6103 should be clear in authorizing such disclosure to both U.S. attorneys and Strike Force attorneys. Strike force attorneys, for example, sometimes need tax information to successfully prosecute organized crime figures.

DISCLOSURE TO STATE OFFICIALS

26 U.S.C. §6103	S.732
No comparable provision.	Adds a new paragraph (7) to subsection (i) Provides authorized officials with authority to obtain an ex parte court order authorizing the redisclosure of tax information which evidences a violation of a State felony statute. Under this provision, a court can authorize redisclosure to a State attorney general or a district attorney upon finding that (i) on the basis of reliable information, there is reasonable cause to believe a State felony has or is occurring; and (ii) there is reasonable cause to believe that the information is relevant.

GAO Comments

Present law does not authorize the redisclosure of tax information concerning non-tax State crimes. S.732 would authorize certain Federal officials to obtain an ex parte court order authorizing redisclosure when the information relates to State felony violations. Although there is a need for this redisclosure authorization, we would suggest a modification to this section to accomodate privacy concerns. Redisclosure should be made only to State attorneys general. The attorneys general would, of course, be authorized to further redisclose the information as necessary to carry out their specific criminal enforcement responsibilities. Also, IRS should be notified of redisclosures to State attorneys general, as well as any redisclosures made by these State law enforcement officials.

Senator **Grassley**. Thank you very much.

I would like to start by asking if S. 732, or similar legislation is enacted, do you believe the taxpayers will stop reporting income derived from illegal activities?

Mr. **Anderson**. Yes, sir. I would say that we would probably never see another return with narcotics listed as an occupation.

Senator **Grassley**. In addition, if taxpayers stop reporting income derived from illegal activities, how will the return information assist other Federal agencies conducting criminal investigations?

Mr. **Anderson**. That is a very good question, sir. There would not be as much information of that nature in their files to report.

I would say probably the type of information that would be of most value in IRS files would be unaccounted for income of some kind of another under miscellaneous income categories which is another device that some of these people have used. IRS could provide information like that.

Senator **Grassley**. Have the actions of IRS and Justice in attempting to administratively simplify the disclosure process by decentralizing speedy approval of disclosure requests been successful?

Mr. **Anderson**. Our limited followup work indicates that law enforcement agencies still see the problem basically as it was before.

Senator **Grassley**. What other measures should be undertaken, if you have any ideas?

Mr. **Anderson**. Let me defer to John Gunner on my right, sir.

Mr. **Gunner**. Mr. Chairman, there is only one additional administrative action that we have been able to identify that could possibly be taken, and it has to do with a high level directive, perhaps at the Attorney General level, to try to get U.S. attorneys and strike force attorneys to start using the authorized access mechanisms that are in the act now. Beyond that, we have not been able to identify any additional administrative actions that can be taken.

Senator **Grassley**. How about changes made by statute?

Mr. **Gunner**. There are numerous statutory changes, we believe, that are needed to both facilitate and encourage use of access mechanisms under current law. We specify them in the appendix to our full statement.

Senator **Grassley**. In your statement, you state that all corporate return information should be subject to the same standard for disclosure, irrespective of the number of shareholders. Why?

Mr. **Anderson**. That is correct, sir. We believe that it is difficult to make a distinction, as Senator Nunn said, between a partnership with two persons and one with three persons. We believe that they are all entitled to the same protections of the law.

Senator **Grassley**. So, then, you would not even go as far as he did by saying that some number significantly greater than two would be a proper number.

Mr. **Anderson**. That is correct.

Senator **Grassley**. You say that there should be no distinction.

Mr. **Anderson**. That is correct.

Senator **Grassley**. Yet, on the other hand, as I recall Senator Nunn's statement, he did argue for a difference in the application of the law, but maybe a larger number than two.

Mr. **Anderson**. Yes, sir. I think trying to decide what that number would be, would be an almost impossible task. I guess, we believe there is no compelling reason why even these larger organizations shouldn't enjoy the same protections. We believe that even with respect to them, there should be some kind of a justification to have access to the records of the organization, whatever its nature.

Senator **Grassley**. Thank you, Mr. Anderson, and representatives of the General Accounting Office, for your testimony. We will use your information in deciding the end product of this legislation.

Mr. **Anderson**. Thank you very much, Mr. Chairman.

Senator **Grassley**. The next witness Mr. John M. Walker, Jr., Assistant Secretary for Enforcement and Operation, Department of the Treasury.

Mr. Walker, would you like to introduce your staff?

Mr. **Walker**. On my left I have Jordan Luke, Assistant General Counsel of the Treasury.

Senator **Grassley**. Would you proceed with your summary. Do you have a written statement you want incorporated in the record?

Mr. **Walker**. No, Mr. Chairman, I just have a very brief statement that I would like to make today. I don't have a written statement to submit.

STATEMENT OF JOHN M. WALKER, JR., ASSISTANT SECRETARY FOR ENFORCEMENT AND OPERATIONS, DEPARTMENT OF THE TREASURY, ACCOMPANIED BY JORDAN LUKE, ASSISTANT GENERAL COUNSEL, DEPARTMENT OF THE TREASURY

Mr. **Walker**. Mr. Chairman, and members of the subcommittee, it is a pleasure to be able to testify today on behalf of the Department of Treasury in support of the administration's proposed tax disclosure amendments, which were submitted today by the Department of Justice.

In this regard, we wholeheartedly endorse the comments made by Deputy Attorney General Edward C. Schmultz in his prepared statement to this subcommittee. As Commissioner Egger of the IRS has testified, the Treasury Department's support of this measure is unqualified.

In particular, I speak for the Office of the Assistant Secretary of Treasury for Enforcement and Operations. This Office includes among its responsibilities Treasurywide law enforcement policy and supervision of the activities of the Secret Service, U.S. Customs Service, and the Bureau of Alcohol, Tobacco and Firearms. My comments will be general and brief.

The administration's bill will greatly assist these law enforcement enforcement agencies in developing information to meet the difficult burden in criminal cases of proof beyond a reasonable doubt. Under this bill, there will be substantial safeguards for the individual taxpayer. Court orders will still be required before return information, including the tax return itself, can be released.

Nonreturn information will only be made available by the IRS upon written request of certain responsible agency officials, and then only for use in administrative judicial or grand jury proceedings.

As a former Federal prosecutor myself, as an assistant district attorney for the Southern District of New York in the early 1970's, I can speak personally to the prosecutor's need for access to tax information.

First, this information usually provides, early in the investigation, a financial picture of the defendant's activity which may well relate to the charges under investigation. This is particularly true in cases of drug trafficking, stock manipulations, and other forms of crime based upon greed.

Second, tax returns are valuable because they often provide leads to the defendant's associates, business connections, and other sources of income. They can also assist in locating witnesses needed to perfect a case.

Finally, where evidence of crime comes to the attention of the IRS, and the IRS alone, it is important, indeed essential, that the IRS be required to disclose this information to other law enforcement authorities.

From my more recent experience as Assistant Secretary for Enforcement and Operations, I know that the existing section 6103 has created a frequently unsurmountable barrier to effective and meaningful cooperation between the IRS and other Treasury law enforcement agencies.

For instance, IRS has had information concerning violations of the customs smuggling and tariff laws, which they are precluded from disclosing because of the prohibition in the current tax law.

In addition, I have been recently informed of two pending smuggling cases being investigated by the Customs Service, involving currency and precious gems, where tax return information would be invaluable to their final resolution, but where the information cannot be obtained in a timely fashion under the present law.

While the administration's proposal facilitates access to tax related information, it still retains important privacy safeguards which were not present prior to the passage of the Tax Reform Act of 1976, and which meet the requirements that were generated at that time. The administration's proposal does, however, permit more timely and realistic access to such tax information when it is deemed relevant to ongoing nontax criminal cases. In my view, Mr. Chairman, this access is essential.

In short, the Treasury Department stands firmly with the Department of Justice in supporting the administration's proposed amendments to section 6103.

Thank you very much.

Senator **Grassley**. Thank you very much.

I have just one question for you. Doesn't the administration's proposal allow Federal law enforcement officials to obtain tax information from the IRS under a standard that is less than that which would be necessary to obtain the same information from the taxpayer or other private sources?

Mr. **Walker**. That is not my understanding.

Senator **Grassley**. It is not your understanding?

Mr. **Walker**. No.

Senator **Grassley**. I was thinking about the probable cause.

Mr. **Luke**. Mr. Chairman, if you will examine section 7602 and 7609, which are included in the administration bill, you will find the Internal Revenue Service currently has procedures for administrative summonses. Those summonses don't work off any more stringent standard than the standard that would be applicable for transfer of the information from the Internal Revenue Service.

Senator **Grassley**. All right. Thank you very much for your testimony.

Mr. **Walker**. Thank you very much, Senator.

Senator **Grassley**. If it is all right with the next two witnesses, I would like to call on Mr. Alexander and Mr. Kurtz simultaneously, because you are both former Commissioners of Internal Revenue. We did not set up as a panel, but it might not only facilitate things, but it might make your communication easier if you had reason to communicate with each other.

Just for the record, I would like to state that Mr. Alexander, if my information is accurate, was Commissioner during the Nixon and Ford administrations, from May of 1973 until February of 1977, and Mr. Kurtz was Commissioner during the Carter administration, from February of 1977 until he retired in the summer of 1980. Is that correct?

Mr. **Alexander**. That is correct, except that I was the first Commissioner under the Carter administration, but for a very brief period of time. But we constitute the series that Senator Nunn talked about.

Mr. **Kurtz**. I lasted beyond the summer, and into the fall of 1980, but that is close enough.

Senator **Grassley**. Which one of you will want to go first.

Mr. **Alexander**. I am the elder, so I will go first. He knows everything about the subject, so he will cover it.

STATEMENT OF DONALD C. ALEXANDER, FORMER COMMISSIONER, INTERNAL REVENUE SERVICE, PARTNER, MORGAN, LEWIS & BOCKIUS, WASHINGTON, D.C.

Mr. **Alexander**. Mr. Chairman, I am here purely in my personal capacity, and I have not submitted a prepared statement. I would like to do so, if the record is going to remain open.

Senator **Grassley**. The record is normally open for about 14 days. As long as there is not any rule to the contrary, I will say that it will be open for 14 days.

Mr. **Alexander**. Then, I expect to submit a statement for the record, Mr. Chairman, which will detail more than my very brief oral statement to you.

There are two problems basically with S. 732, as I see it. First, to use Senator Baucus' phrase, and a phrase that has been repeated by others today, it employs the classic sledge hammer to kill a gnat.

It does have certain provisions which would probably be beneficial to a somewhat awkward system, and that have a place, and a real place, in an effective system of law enforcement. On the other hand, the detriments of the bill, Mr. Chairman, as I see it, greatly outweigh the benefits.

Second, to touch on the problem that goes beyond the bill in some respects, but not in others, the real issue here is the role of

IRS. Should IRS devote itself to administration and criminal enforcement of the tax laws of this Nation, or should it be an all-purpose criminal investigative unit, responding and responsible to entities having other needs and having other missions of great importance?

Certainly we need to deal with drug trafficking, and we need to deal with it whether it is conducted by individuals or corporations of two or more shareholders, by the way. But we have an agency, the Drug Enforcement Agency, charged with that primary responsibility, that is all they have to do. Let's make sure that they are given the resources to do it, let's assist them in doing their job, certainly, and let's have strong oversight to make sure they do it right.

Somehow, if we seem to be losing a war against drug trafficking, but who is losing it? The agency charged with fighting it, and charged with winning it.

Similarly, the FBI has title 18 responsibilities, and I think that under its present leadership, it conducts itself very well and very effectively. I can't say that it always has. I can't say that it always cooperated as closely with the Department of Justice strike forces as some would have liked.

In the past IRS filled a void in law enforcement, but in filling that void, the IRS' personnel, too thin to meet its tax responsibilities, was stretched even thinner. IRS powers were used for nontax purposes, and IRS was frequently struck down by the courts, and in the 1976 act Congress curtailed IRS powers.

IRS information was shared to such an extent that there were frequent accusations, when I came to office, that IRS was a lending library. Those accusations has some foundation.

The question we have, sir, is whether in an effort to try to make our system work better, we impair tax enforcement and tax administration in two respects: One, by diversion of IRS personnel and two, to pick up on what the GAO witnesses said, and what the Chamber of Commerce witness, I believe, will say—to reduce compliance by both those in the illegal sector and those in the legal sector.

Your turn, Commissioner.

STATEMENT OF JEROME KURTZ, FORMER COMMISSIONER OF INTERNAL REVENUE; PARTNER, PAUL, WEISS, RIFKIND, WHARTON & GARRISON, WASHINGTON, D.C.

Mr. Kurtz. Thank you, Mr. Chairman.

My name is Jerome Kurtz, and I, as Mr. Alexander, appear in my individual capacity today.

The bill, S. 732, and the administration's proposed modification, which I have not had much of a chance to look at since it just appeared today, make a number of changes in existing law. Many of them are what might properly be called technical changes. But there are a few major substantive changes, and those are the ones on which I would like to focus.

The basic issue, of course, involves the circumstances under which a taxpayer's books and records are to be made available by the IRS to law enforcement agencies for nontax criminal purposes. Most of the other provisions are, as I say, of a technical nature.

S. 732 and the administration's proposal both properly continue the protection of individual's records. But for most corporations S. 732 would require the Internal Revenue Service to turn over to law enforcement authorities any evidence of nontax crimes that it comes across in the course of an audit.

The question raised by the proposals to disclose corporate tax information discovered in the course of an audit is not so much one of privacy, although in the case of small corporations it borders on that question. It is really a question of efficiency. When Senator Nunn talked about moving the number from two shareholders to 5, 10 or 25, he was focusing only on the privacy issue.

It probably is true that major corporations do not have anything like the claim to privacy that an individual has, but there is quite another reason why this proposed disclosure is a bad idea from a tax administration point of view. In examining major corporations it is essential that the IRS in carrying out is function of verifying the taxable income of the corporation, have free and easy access to virtually all of the information that the corporation maintains.

There is absolutely no doubt in my mind, nor, I think, in the minds of anyone else who has been involved in tax administration, that such access will become far less free if the corporation knows that anything that bears on, or is evidence of the commission of some other crime, misdemeanor or felony, has to be turned over to law enforcement authorities when the agent comes across it.

Such a rule will turn examinations into a game of hide and seek, and dissipate very scarce IRS resources, resources which, I might say, are becoming more and more scarce under current budgets.

It will inevitably divert agents' attention from their main function of tax administration to, I am afraid in some cases, digging around in taxpayers' files looking for interesting tidbits of information—again a dissipation of very scarce resources with, I believe, minimal law enforcement gains.

Restated purpose of this bill was orginally to deal more effectively with narcotics trafficking. It is a long way from talking about narcotics traffickers to the changes in this bill dealing primarily with major corporations in the United States. The organized crime/narcotics goal does not in any way support this diversion of tax administration resources in the corporate area.

I might say that for fiscal year 1980, the Internal Revenue Service examined about 146,000 corporate income tax returns, and about 24,000 returns of exempt organizations. That is almost 200,000 returns. The changes proposed by this bill are in a way equivalent to saying to a Federal agency, "Here is a license to do 200,000 door-to-door searches, see what you can find," because these returns are selected for audit not because there is any reason to believe that there is any misconduct, but simply as part of tax administration. To then turn routine tax examinations into general fishing expeditions is a vast misuse of governmental resources.

There are just two other points that I would like to mention.

One is the ability of the Attorney General and the Department of Justice to turn over information, once it receives it, to State law enforcement agencies.

I might point out that there are 19,000 State and local law enforcement agencies in the United States, 50 percent of which have fewer than 10 employees. When we think about turning over confidential information to law enforcement agencies who do not have the minimum ability to safeguard that information, I have great concern.

The other is a provision which would require the Internal Revenue Service on making a criminal tax referral to Justice, to turn over the entire file, that is, those findings that relate to the tax crime as well as other information that is irrelevant to the tax crime. This, again, I believe is a substantial violation of privacy.

I might add that I have substanial fears that the requirement that IRS turn over strictly nontax information creates a real danger that at some point the Department of Justice or other law enforcement agencies will begin to ask the IRS to do an examination to see if they can find nontax criminal information.

If the ability is there to hand it over, it is but a short step to turn that ability into response to a direction to look for it. I have great fears of that.

Thank you, Mr. Chairman.

Senator **Grassley**. Thank you very much for your statements. I have several questions I would like to ask one or both of you

I think we would be not performing our responsibilities in legislating with the care that we should without referring to your expertise and your experience in this area.

Mr. Kurtz, you suggest that the availability of corporate records on written request by a Federal agency will reduce corporate compliance. Obviously, I am concerned about any reduction in compliance. I am also concerned that the books and records of corporate taxpayers with three or more shareholders may not indicate any significant illegal narcotics activity.

What are your views on this issue?

Mr. **Kurtz**. The point that I was making related to spontaneous disclosures, without a request. But the standard for the requested information is also a problem.

I think the law enforcement gains, if any, will be absolutely minimal. In order to make these changes, to run the risks to the tax administration system, there must be a conclusion drawn somewhere that better cases are undiscovered than the cases that are discovered.

It seems to me there are ample numbers of investigations around without looking to what might be turned up in these corporate investigations, where there is a substantial price to pay, both in fairness and in efficiency.

Senator **Grassley**. Let me give an opportunity to pinpoint the comment you just made by answering this question.

In your opinion, will this bill improve Justice's ability to stop illegal drug traffic?

Mr. **Kurtz**. No.

Senator **Grassley**. What return information might be useful to catch criminal violating our drug laws?

Mr. **Kurtz**. I do not believe it is appropriate to look only at law enforcement. There are changes that would result in more convictions.

I suppose if we did away with the fourth and fifth amendments, we could get a lot more convictions. But it is a balancing of people's individual rights with the needs of law enforcement. It seems to me the balance here comes out very much in favor of keeping tax return information confidential.

Mr. ALEXANDER. One thing to help in the war against the narcotics traffickers is to give the DEA more money. I believe the Senate is taking action to restore some of the budget cut that has been assigned to DEA for whatever reason, and I think it is a very wise move. Another step that should be taken is continual, strong oversight to make sure they do their job right.

The provision that Mr. Kurtz discussed, mandatory turnover of nonreturn information which may constitute evidence of a violation of criminal laws, not only creates the problem that he describes, but creates a further problem. It turns catch-22 on its head, and the Internal Revenue would have a catch-22.

What if the Internal Revenue found, without looking for it, evidence which to a skillful person would indicate a Federal criminal violation of the antitrust laws, but Internal Revenue does not have that skill and doesn't know that it has found evidence which shows a violation of a Federal criminal law. Then Internal Revenue itself would be in violation of this provision.

Senator GRASSLEY. I would like to ask both of you my last question.

Are there any ways in which the IRS can administratively improve cooperation between the Service and Federal law enforcement agencies?

Mr. KURTZ. I think there are, and I think a lot of it has been done already. Let me say, there are also a number of ways in which the Justice Department can improve cooperation. This is not just a one-way street.

My experience was, Senator Grassley, that 6103 as it exists today has some problems but it is perfectly workable. The fact that there have been so few requests for information under existing 6103 is the fault of the Justice Department in the way they handle 6103.

If you look at the 6103 requests by the Justice Department, the requests for court orders, over the years, U.S. attorney by U.S. attorney, you will see that over half of the U.S. attorneys have never made such a request, never. The requests that have been made have been made by very few.

The answer is that if a U.S. attorney wants to use it, and takes the time to read the code and the regulations, it works perfectly well. But there has been a great hesitancy on the part of Justice to use what they already have.

Again, I am not saying that this section is perfect. The series of technical amendments I think are fine. But it is okay the way it is, if people would use it.

Senator GRASSLEY. Mr. Alexander.

Mr. ALEXANDER. Mr. Chairman, I would associate myself with that. I believe that in the particular part of 6103 that we are discussing, the application to a court for an appropriate order, the suggestions in the Department of Justice's bill do make sense.

I understand, however, that there has never been a turn down under present law, and I don't believe that any of the witnesses testifying in favor of the bill indicated otherwise today, or in prior hearings. Nevertheless, the current standards are, read literally, extremely tight, and it would make sense to streamline the process to provide, as the Justice proposal would, for field officials, having responsible positions, to be able to act without taking the case to Washington; to provide for a magistrate to be in a position to grant the order upon appropriate showing; and to relax somewhat the very strict legislative standards.

But the other provisions of S. 732 create far more problems to our system; the far greater likelihood of noncompliance not only by those who make their living through illegal means, but major corporations, than any possible benefit to law enforcement.

Mr. KURTZ. I agree with that.

Senator GRASSLEY. That is all the questions I have. Thank you very much.

I would now like to call on Mr. Edwin Cohen, chairman, Taxation Committee, Chamber of Commerce of the United States.

STATEMENT OF EDWIN S. COHEN, CHAIRMAN, TAXATION COMMITTEE, CHAMBER OF COMMERCE OF THE UNITED STATES

Mr. COHEN. Thank you very much, Mr. Chairman.

My name is Edwin S. Cohen. I am a member of the board of directors, and chairman of the Taxation Committee of the Chamber of Commerce of the United States. I appear before you on the chamber's behalf.

I am a member of the law firm of Covington & Burling of Washington, D.C.

The chamber's memberships consists of more than 200,000 business, trade association, and local and State chamber of commerce members.

Although we strongly support the goal of S. 732 to strengthen the Government's ability to combat narcotics traffickers and organized crime, we strongly oppose some of the broad proposals for disclosure of tax information set forth in the bill that have been discussed here today.

If enacted, S. 732 would allow other Government agencies, without court order, to have what we believe would be unwarranted access to business records and information that are now routinely supplied to the Internal Revenue Service by taxpayers in connection with tax audits.

Indeed, it would require the IRS on its own initiative to disclose to other agencies any such information—and I quote—"that may constitute" evidence of a violation of any Federal criminal law, and would permit persons in the other agency, in turn, to disclose the information to other Federal Government personnel or witnesses.

The possibility of such disclosure without judicial approval regarding possible violations of any of the many Federal laws having criminal sanctions, we think will make businesses hesitant about furnishing information to the IRS because of the concern that it may initiate or affect nontax investigations or actions by other agencies.

I need not remind you, Mr. Chairman, of the many Federal laws that regulate business behavior and impose criminal sanctions for violations. These would include, for example, the Occupational Safety and Health Act, [OSHA], the consumer products laws, the antitrust laws, the securities laws, and environmental laws—misdemeanors as well as felonies. Violations of these laws constitute crimes, and the interpration and application of these laws are often uncertain.

Larger companies are continually under audit by the IRS. They maintain a staff of tax employees that constantly provide the IRS personnel with financial and operating data relating to the taxable years that are under audit. But the larger companies do not, as a rule, forward the information they plan to disclose to their corporate counsel's office for approval before it is turned over to the IRS.

Under S. 732, businesses necessarily would be hesitant about furnishing information to IRS agents without review by legal counsel familiar with these many nontax Federal laws that impose criminal sanctions.

Smaller firms would be disproportionately affected by the bill. When they are audited, they tend to rely on an accountant to prepare and submit and explain information to the IRS during the course of a tax audit.

Lawyers are not customarily involved in the tax audit unless and until a dispute arises between the IRS and the taxpayer as a result of the audit. Under S. 732, however, businesses would be hesitant about furnishing confidential information to the IRS without review by a lawyer who has knowledge of Federal statutes that affect that industry and contain criminal sanctions.

We have a very real concern at the chamber that this additional burden placed on the already overburdened small business sector would impair the maintenance of a strong and healthy small business community.

I would point out, Mr. Chairman, that IRS agents are not trained to be familiar with the many nontax Federal laws that contain Federal sanctions, nor to analyze information to determine whether they may constitute a violation of any of these laws, requiring forwarding of the information to the Justice Department or other agencies.

Thus, neither the taxpayer nor the agent would know during the course of the audit whether the IRS on its own initiative would have to disclose the information to the Justice Department or other Federal agency for consideration under these many nontax criminal laws, or whether it could be obtained under court order by one of the many assistant U.S. attorneys throughout the country, or by some other Federal agencies.

We understand, Mr. Chairman, from the testimony today that the proposed administration bill will modify some of the provisions of S. 732. We look forward to the opportunity of studying those changes in the hope of achieving the goal of the legislation, without undue burden on taxpayers undergoing tax audits.

Thank you.

[Statement of Mr. Cohen:]

STATEMENT
on
S. 732
before the
SENATE FINANCE COMMITTEE
SUBCOMMITTEE ON OVERSIGHT
of the
INTERNAL REVENUE SERVICE
for the
CHAMBER OF COMMERCE OF THE UNITED STATES
by
Edwin S. Cohen
November 9, 1981

My name is Edwin S. Cohen. I am a member of the Board of Directors and Chairman of the Taxation Committee of the Chamber of Commerce of the United States, on whose behalf I am appearing today. I am a member of the law firm of Covington & Burling, of Washington, D.C., and I am accompanied today by Kenneth D. Simonson, of the Chamber's Tax Policy Center.

On behalf of the Chamber's over 200,000 business, trade association, and local and state chamber members, we welcome this opportunity to present our views on the general issues involved in S. 732. We understand that there may soon be other bills relating to these issues.

Introduced March 17, 1981, by Senator Nunn, of Georgia, and others as a revision of earlier bills, S. 732 proposes amendments to current Internal Revenue Code Section 6103, entitled "Confidentiality and Disclosure of Returns and Return Information." The bill was approved by the Senate on July 27, 1981 as an amendment to the Economic Recovery Tax Act of 1981. It was deleted from the new tax bill in conference with the understanding that hearings on the proposals would be held.

Although we strongly support the goal of S. 732 to strengthen the government's ability to combat narcotics traffickers and organized crime, we strongly oppose the broad proposals for disclosure of tax information set forth by the bill. If enacted, S. 732 would allow other government agencies, without court order, to have unwarranted access to business records and information now routinely made available by taxpayers to the Internal Revenue Service in connection with tax audits. Indeed, it would require the I.R.S. on its own initiative to disclose to other government agencies any such information that "may constitute" evidence of a violation of any federal criminal law, and would permit persons in the other agency in turn to disclose the information to other federal government personnel or witnesses.

The possibility of such disclosure, without judicial permission, regarding possible violation of any of the many federal laws having criminal sanctions will make businesses hesitant about furnishing information to the I.R.S. because of concern that it might initiate or affect non-tax investigations or actions by other agencies. Lawyers for taxpayers may have to review such information prior to disclosure to the I.R.S. because of possible collateral effect on non-tax matters. This would tend to delay or inhibit the disposition of tax audits and increase the expense of those audits to taxpayers. While the bill would affect all businesses with more than two individual owners, it would be a special burden on small businesses that do not customarily have lawyers involved in tax audits unless and until a disagreement develops between the I.R.S. and the taxpayer.

ANALYSIS

Under present Section 6103(i)(1), information given by a taxpayer to the I.R.S. during the course of a tax audit may not be disclosed by the I.R.S. to other government agencies without a federal court order. This information can be disclosed only if a federal judge determines that, based on the facts submitted in an application authorized by an Assistant Attorney General or his superior, there is reasonable cause to believe that a specific criminal act has been committed, that the return or related information is probative evidence of a criminal act, and that the information cannot reasonably be obtained elsewhere. Additionally, under Section 6103(i)(3), the I.R.S. may (but is not required to) disclose to the agency charged with enforcing federal criminal law any such information that may constitute evidence of a criminal violation.

Under the proposals of S. 732, however, the I.R.S. would be required to disclose such information given to the I.R.S. by business entities owned by more than two individuals whenever it received a written request from another federal agency. Moreover, if such information "may constitute" evidence of a criminal violation, the I.R.S. on its own initiative must disclose it to other federal agencies.

IMPACT ON THE BUSINESS COMMUNITY

S. 732 or legislation containing similar broad disclosure provisions would pose significant problems for businesses with more than two owners, particularly for smaller firms.

Larger companies are continually under audit by the Internal Revenue Service. They maintain a staff of tax employees who constantly provide I.R.S. personnel with financial and operating data relating to the taxable year or years being audited. However, larger companies do not as a rule forward the information they plan to disclose to the I.R.S. to their corporate counsel's office prior to disclosure. Under S. 732, businesses necessarily would be hesitant about furnishing information to I.R.S. agents without review by legal counsel familiar with non-tax federal laws that impose criminal sanctions.

The bill would permit a federal agency official having jurisdiction over enforcement of any such laws, who may be considering whether the firm or its customers or suppliers may have violated a criminal statute, to obtain from the I.R.S. on his own written request all of the firm's underlying tax return information, including books and records gathered during the course of an I.R.S. audit. Apparently the I.R.S. agent's supporting memos, analyses and mental impressions would also be subject to disclosure. We need not remind the Committee of the many federal laws that regulate business behavior and impose criminal sanctions. These would include, for example, the Occupational Safety and Health Act, the Robinson-Patman Act, the Foreign Corrupt Practices Act, the securities laws and environmental laws. The interpretation and application of these laws are often uncertain.

The possible effect of disclosure to other agencies on their own request would be a matter that would require a company's serious consideration before information is furnished to an examining agent of the I.R.S. Moreover, there would be concern over the possibility of the other agency disclosing the information to potential witnesses, some of whom might be competitors of the taxpayer, as would be permitted by the bill.

Smaller firms would be disproportionately affected by S. 732. When they are audited, they tend to rely on an accountant to prepare, submit and explain the information to the I.R.S. during the course of a tax audit. Lawyers are not customarily involved in tax audits unless and until a tax dispute between the I.R.S. and the taxpayer develops as a result of the audit. Under S. 732, however, businesses would be hesitant about furnishing confidential information to the I.R.S. without review by a lawyer having knowledge of federal statutes which affect that industry and which contain criminal sanctions. We have a very real concern that this additional burden placed on the already overburdened small business sector would impair the maintenance of a strong and healthy small business community.

S. 732 would make it mandatory for the I.R.S. to disclose information sought by other agencies in two situations. First, the I.R.S. would be required to furnish all underlying return information (other than the return itself) and ancillary documents upon written request of an agency head, the Attorney General or his designee, all without a court order. The section-by-section analysis of the bill states that it is anticipated that the Attorney General would designate the many assistant United States attorneys throughout the country as persons authorized to demand disclosure from the I.R.S. The Attorney General under S. 732 could conceivably designate any Justice Department employee, even one not directly involved in the case. If S. 732 became law, the I.R.S. would be required to disclose confidential information on request, even when there is no judicial determination of probable cause or that the material sought is relevant to a matter relating to the commission of a criminal act.

Second, the I.R.S. would be required to disclose on its own initiative such information if it "may constitute" evidence of a violation of a federal criminal law to the agency charged with enforcing the law. I.R.S. agents are not trained to be familiar with the many non-tax federal laws that contain criminal sanctions, nor to analyze information to determine whether it "may" constitute a violation of any of those laws. Thus neither the agents nor the taxpayer would know during the course of the audit whether the I.R.S. on its own initiative would have to disclose the information to the Department of Justice or other federal agency for consideration under those many non-tax federal laws. We believe such a requirement would impose a most serious burden of decision and review both on I.R.S. and business taxpayers, and would delay and hamper the administration of the tax laws.

CONCLUSION

The Chamber strongly supports the goal of S. 732 to provide the nation with greater protection from organized crime. However, we object most seriously to several of the bill's specific provisions. First, the broad disclosure that would be allowed under the bill would unreasonably burden all business and would particularly disadvantage smaller businesses. Second, the disclosure that would be permitted under the bill would be made more onerous by the universe of federal employees able to request information and share it with potential witnesses and others. Third, the I.R.S., through the mandatory disclosure provisions, would be diverted from its primary role of tax administration and enforcement. We respectfully submit that the scope of the bill should be significantly narrowed before it is enacted.

Senator **Grassley**. Along that line, would you have any suggestion for limiting the impact of the legislation in the area affecting small businesses? You pointed out a special problem for small businesses?

Mr. **Cohen**. I would agree with the comment made earlier that the problems of small businesses are not different from those of large businesses. The problem that we are concerned about relates to information that now is voluntarily and routinely supplied to the IRS in the course of a tax audit. That information, under this bill, would have to be made available to other agencies.

I don't see the difference between the small business and the large business in that regard. I think the larger businesses would be just as hesitant and involved in just as much of a problem. The only difference is that the expense of having lawyers review the information before it is submitted is likely to be more burdensome on the small business than on the large business.

Senator **Grassley**. In your opinion, will S. 732, or any similar proposals cause businesses to stop voluntarily giving IRS information that they now give to the agents of that agency?

Mr. **Cohen**. I think, as the bill is presently drafted, it will cause a good deal of hesitation. I think that could be changed. I seems to me that most of the objectives of the Justice Department and the administration could be satisfied with some relatively minor changes in the existing law, without going as far as S. 732 presently does.

I would hope that the needs of the Justice Department, and the needs of the revenue system and taxpayers could be reconciled with some further work before the bill is enacted.

Senator **Grassley**. Thank you, Mr. Cohen. These are all the questions I have. Thank you for your testimony and your contribution to the discussion of this very important subject.

Mr. **Cohen**. Thank you, Mr. Chairman.

Senator **Grassley**. I would like to call Mr. Wade J. Henderson, legislative counsel, American Civil Liberties Union.

STATEMENT OF JOHN H. F. SHATTUCK, NATIONAL LEGISLATIVE DIRECTOR, AMERICAN CIVIL LIBERTIES UNION

Mr. **Shattuck**. Mr. Chairman, if I could make a correction for the record. Mr. Henderson, my deputy, is not here today. I am John Shattuck, the legislative director of the American Civil Liberties Union.

Senator **Grassley**. I have a statement here in your name, and I was confused myself.

Mr. **Shattuck**. I am not quite sure how that confusion resulted, but I am glad to be here. I have been here before, Mr. Chairman, and I will try to be brief in light of the hour, although not to slight the importance of the subject.

This is a subject of great importance to all of us, the American Civil Liberties Union and the other witnesses who have testified here before.

I would like to state for the record that our views are the same today as they were the last time we appeared, and they are the same as the views of the American Bar Association, and the American Bankers Association, who I believe will be communicating with you, although they were not able to appear at this hearing. I am not saying that our testimony is precisely the same as theirs, but our views are the same.

Our views are essentially that the Tax Reform Act of 1976 was adopted by Congress after considerable deliberation, and that the privacy protections in that act should not be changed.

The act is a product of extensive evidence, real evidence, well-documented by Congress of substantial abuse of IRS records by Government agencies for nontax purposes, which had a severe impact on the administration of IRS, as well as the rights of American citizens. I have reviewed a great deal of that evidence in my prepared testimony.

Although the act is by no means perfect, it provides a minimum degree of privacy protection of tax records. It requires the Government to meet a reasonable standard of proof to justify disclosure, and disclosures may only be made following the independent judgment of a Federal judge.

IRS has been given enormous, unparalleled powers by the Congress, powers that are well used in the collection of taxes, but we must remember that these are powers to collect information from individuals about every aspect of their private lives.

Because of the threat that such powers could be used to deny constitutional rights, the Supreme Court of the United States has carved a narrow exception for IRS to the fifth amendment privilege against self-incrimination. But, in return, IRS, as you have heard from the former Commissioners, is obligated to treat the information it collects as absolutely confidential.

This is not only a constitutional requirement, but it is a requirement of good and fair tax administration because taxpayers should be encouraged to provide information about themselves, and in return they should be given confidence that it will not be used beyond IRS.

In introducing this legislation, Senator Nunn identified his central concern as the insufficient level of IRS participation in the Government battle against organized crime and drug trafficking.

In our view, casting this issue in that light fundamentally distorts the purpose of IRS, which is the collection of taxes, because it was not designed to participate in the battles that Senator Nunn is talking about, which are important battles, but they are not battles to be fought by IRS.

These questions of constitutional policy concerning the disclosure and dissemination of tax information provide the background against which we have reviewed the specific proposals that are under discussion today. Let me just quickly review our concerns about aspects of S. 732.

First is the change in the definition of protected information so that nothing, except taxpayer return information, would be protected against disclosure for nontax purposes, under the bill a distinction is made between corporate and noncorporate records. I would like to associate myself with the remarks of the previous three witnesses on that point.

Beyond that, we oppose the change in the standards of proof that an agency would have to meet to obtain a court order for access to IRS information. I would like to point out at this stage that Senator Nunn claims that his bill would provide the same standard of proof as is required for a wiretap.

That is simply not true. Under laws passed by the Congress, the Omnibus Crime Control and Safe Streets Act of 1968, it is necessary to show probable cause that the information that is sought to be obtained under a wiretap will, in fact, be useful for criminal investigative purposes.

Whereas, under S. 732, all that is necessary to show is reasonable cause to believe that it may be relevant to a criminal investigation. There is a very important distinction here and I think if Senator Nunn wants the wiretap standards, then he really should endorse the higher standard, which of course is the standard in the current law.

A third area is the possibility that information obtained under court order could be further disseminated within the Government, without any checks against that further dissemination.

Fourth, we are concerned, as previous witnesses are, about the dissemination to State agencies, some 19,000 State agencies, without any further checks on the use of the information that would be disclosed.

Finally, the disclosure to foreign governments is also a matter of grave concern to us. Many foreign nations have standards of proof in their criminal laws that are very different from the standards required under our Constitution, or by definitions of criminal laws that have been enacted by Congress. In fact, there may not even be criminal conduct under the laws of this country when the tax information is disclosed pursuant to a request under a treaty. So we are very concerned about that area.

Finally, Mr. Chairman, let me just end my remarks on a positive note in the sense that we, as the two former IRS Commissioners, would endorse some of the procedural changes that are before this subcommittee.

We think that the appropriate way for this issue to be addressed, and the evidence certainly points in that direction, is for the procedural streamlining of the way in which this whole approach under existing law works. We endorse the imposition of time limits, the extension to magistrates of the authority to rule on Government applications and the provision allowing attorneys for the Federal Government, rather than the heads of agencies, to apply for disclosure.

But that is very different from altering the fundamental structure that the legislation that was passed in 1976 set up. Until today, in fact, the IRS itself has always said this is an appropriate procedure, a necessary procedure. It is also protective of individual privacy, as well as the fair administration of the tax laws.

We would be happy to answer any questions, and to work further with the subcommittee as you consider this legislation.

[Statement of Mr. Shattuck follows:]

ACLU
AMERICAN CIVIL LIBERTIES UNION
WASHINGTON OFFICE

600 Pennsylvania Ave., SE
Suite 301
Washington, DC 20003
(202) 544 1681

John Shattuck
DIRECTOR

Jerry J. Berman
David E. Landau
Wade J. Henderson
LEGISLATIVE COUNSEL

Laura Murphy
LEGISLATIVE
REPRESENTATIVE

Hilda Thomson
ADMINISTRATIVE DIRECTOR

National Headquarters
132 West 43 Street
New York, NY 10036
(212) 944 9800

Norman Dorsen
PRESIDENT

Ira Glasser
EXECUTIVE DIRECTOR

STATEMENT OF

JOHN H.F. SHATTUCK, NATIONAL LEGISLATIVE DIRECTOR

WADE J. HENDERSON, LEGISLATIVE COUNSEL

on

S. 732

before the

SUBCOMMITTEE ON OVERSIGHT OF THE INTERNAL REVENUE SERVICE

COMMITTEE ON FINANCE

UNITED STATES SENATE

November 9, 1981

I am pleased to testify this morning on the privacy of taxpayer information, an issue of much importance to the American Civil Liberties Union. I am the Legislative and Washington Office Director of the ACLU, a nationwide, nonpartisan organization of more than 250,000 members devoted to the protection of individual rights and liberties under the Constitution. I am also the author of a textbook, Rights of Privacy (National Textbook Co. 1977).

For many years the ACLU has played an active role in the effort to safeguard individual privacy from broad intrusion by government and private recordkeeping practices. Through a project on privacy and data collection which we sponsored from 1973 through 1978, the ACLU provided advice--and in some instances legal representation--to individuals whose rights and interests were adversely affected by the recordkeeping and dissemination practices of governmental and private institutions. We also sought to publicize in a monthly Privacy Report the many ways in which privacy has been eroded in a society where personal information is increasingly recorded by third parties and used for a wide variety of purposes, without the consent or even the knowledge of the person involved.

The ACLU is particularly concerned about the issue of taxpayer privacy, and has testified frequently in congressional and other hearings on this subject, including hearings of this committee when it was considering the Tax Reform Act of 1976; and last year when it considered a bill similar to the one under consideration today. We were strong opponents of the Justice Department's earlier effort to amend the Act in 1977, and we oppose many of the proposed amendments before the Committee today.

Privacy of Tax Records

The disclosure and summons provisions of the Tax Reform Act of 1976 are the product of a grave concern for the privacy of tax records held by the IRS. The provisions were generated by revelations, over a period of several years, of a widespread pattern of abuse of IRS records by government agencies for non-tax purposes. Among the many improprieties that were revealed by various investigations of governmental intelligence operations were a number of projects initiated within the IRS as a result of pressure brought to bear on that agency by governmental law enforcement agencies. These projects included the Ideological Organizations Audit Project and the Special Service Staff (1969-73) which targeted more than 8,000 individuals and 3,000 groups for extensive investigation specifically because of their political activities. The SSS operated in secrecy and was abolished in 1973 when IRS Commissioner Donald Alexander learned of its existence. These internal IRS projects seriously threatened the contitutional rights of all taxpayers. The projects were the product of external pressures exerted by Congress, the White House and government law enforcement agencies who claimed that the IRS was not participating sufficiently in the governmental battle against crime.

More central to the origins of the disclosure provisions of the 1976 Act were the extensive revelations of abuse of IRS information by other agencies of the government which had solicited the information from the IRS. See Final Report, Book III, Senate Select Committee on Study of Governmental

Operations with Respect to Intelligence Activities, 94th Cong., 2d. Sess. [Church Committee] (1976). Between 1966 and 1974, the FBI, either directly or through the Justice Department made approximately 200 requests to the IRS for tax returns. 65% of these requests were for two counter-intelligence (COINTELPRO) programs conducted by the FBI--the Key Activist program aimed at leaders of the anti-Vietnam War movement, and the Key Black Activist program, aimed at leaders of the so-called Black Nationalist movement. In addition, the FBI made numerous ongoing requests to the IRS for lists of contributors to ideological organizations under investigation by the Bureau. In this manner, the FBI obtained information offered voluntarily to the IRS by groups to assist in enforcement of the tax laws. Between 1957 and 1972, the Central Intelligence Agency made a number of unofficial requests to the IRS for tax return information on persons the CIA was investigating.

Finally, the Senate Committee that investigated the Watergate burglary revealed extensive use of IRS records by the White House against political opponents of the Nixon Administration. Indeed, abuse of tax information was one of the central components of the Nixon Administration's broad pattern of intelligence operations aimed at harassing and intimidating political "enemies."

Before the Tax Reform Act of 1976, the IRS lacked any meaningful standards by which to judge the numerous requests for information it received from other government agencies. Though a procedure for determining the legitimacy of requests did exist, it was so vague, and so widely ignored as to be useless. Indeed, in 1968 when the Chief of Disclosure of IRS learned of the procedure, he termed it "illegal." The Church Committee found that in the absence of any meaningful guidelines, the IRS could not judge whether the request was legitimate. Consequently, the Committee noted, the "IRS had delegated the determination of the propriety of the request to the requesting agency." _Final Report_, Senate Select Committee to Study Government Operations. With respect to Intelligence Activities, Book III, p. 840.

The Tax Reform Act was designed to remedy this legacy of abuse of IRS information. Although the Act is by no means stringent, it provides a degree of protection of IRS records. It requires the government to meet a reasonable standard of proof to justify disclosure. Furthermore, such disclosure may only be made following the independent judgment of a federal judge. These safeguards were all designed with specific reference to known abuses of IRS information by government agencies.

Sensitive Nature of Taxpayer Information

A person's tax returns, and the records of his financial transactions with a bank or another private entity, are a reflection of that person's life. Those records mirror, often in great detail, the personal habits and associations of individuals. The beginning of a tax return gives name, address, social security number, identity and dependents and the taxpayer's gross income. Various schedules may indicate political and religious affiliations and activities, medical or psychiatric treatment, union membership, creditors, investments and holdings. Additional documents compiled by the taxpayer and pertaining to statements made on a tax return but not filed with the return contain a similar wealth of sensitive personal information. In 1975, the then IRS Commissioner Donald Alexander noted that the IRS has "a gold mine of information about more people than any other agency in this country." Committee Print, Confidentiality of Tax Returns, House Committee on Ways and Means, September 25, 1975, at 3.

Apart from information related to tax returns, documentary materials routinely obtained by IRS for the enforcement of the tax laws also contain vast quantities of private information. Bank records, or similar records, reveal the political causes one supports, the books and magazines one buys, the organizations one joins, as well as one's style of life, tastes and habits. People assume that these matters are confidential, and that they do not sacrifice that confidentiality when they conduct financial transactions with the assistance of a bank. This assumption has been acknowledged and embraced by courts across the country. As one state court has noted:

> [I]t is impossible to participate in the economic life of contemporary society without maintaining a bank account. In the course of such dealings, a depositor reveals many aspects of his personal affairs, opinions, habits and associations. Indeed, the totality of bank records provides a virtual current biography. . . Burrows v. Superior Court, 13 Cal. 3d 238, 529 P.2d 590 (1974).

I make these opening observations so that it is clear that the privacy interest an individual has in his or her tax return and bank records is formidable, and must be taken fully into account. Last year, in introducing proposed amendments to the Internal Revenue Code similar to those under discussion today, Senator Nunn noted that "a balance must be struck between the privacy of tax returns and the legitimate needs of law enforcement agencies." Congressional Record, March 11, 1980, p. S2375. The hearings that generated these bills contained testimony principally from law enforcement officials concerning the asserted needs of law enforcement agencies. If the balance to which Senator Nunn referred is to be struck fairly and accurately, it is essential that the privacy interests of individuals be given equal weight.

The Extraordinary Powers of IRS

The IRS is accorded enormous, unparalleled coercive power to obtain information from individuals concerning every aspect of their private lives. The IRS may, without a subpoena or a warrant or any showing of probable cause, require an individual to divulge information. Because of the clear threat such broad powers hold to an individual's constitutional rights to be free from government coercion, the Supreme Court has carved a narrow "required records" exception to the Fifth Amendment, principally for the benefit of IRS. See United States v. Sullivan, 274 U.S. 259 (1927). This exception and the extraordinary authority which Congress has bestowed on IRS create a powerful presumption against any attempt to transfer that authority to other agencies of government.

The statutory authority of IRS to obtain information must not be viewed as creating some form of governmental asset which may then be transferred to other arms of the government pursuing legitimate governmental objectives. The information gained by the IRS does not in any sense "belong" to the Government. Rather, it is held in special trust by the IRS for its unique, important purpose of collecting taxes. Indeed, it is only the unique nature of the IRS function that justifies the extraordinary degree of intrusion that that agency is allowed to make into the lives of individuals. Dissemination of IRS information to other governmental agencies for non-tax purposes, however meritorious, is a violation of the IRS' special trust.

In introducing S. 732, Senator Nunn identified as his central concern the insufficient level of participation of IRS in the government battle against organized crime and large drug trafficking. In our view, casting the question in that light fundamentally distorts the realities of the situation. The IRS is not designed to participate in that battle. Its extraordinary powers were granted for quite another purpose--the collection of revenue and enforcement of tax laws--and are limited to that purpose. To the extent that the IRS has, in the past, strayed from that purpose, it has operated outside its charter. Measures taken to remedy that impropriety are to be lauded; to portray the Tax Privacy Act of 1976 as withdrawing the IRS from the battle against crime is misleading and harmful.

Governmental agencies such as the Department of Justice, the Drug Enforcement Administration and the Federal Bureau of Investigation are not--and should not be--empowered to exercise the same authority as the IRS to compel and use personal records and other information about virtually the entire public. As the Privacy Protection Study Commission noted in its 1977 report:

> It is understandable that other agencies with important responsibilities want to use information the IRS has authority to collect, but they have not, in fact, been vested with the IRS' authority to compel such information. [Report at p. 540.]

We believe that dissemination of taxpayer information and records by IRS to other government agencies, and the summoning of financial records by IRS threaten the constitutional policy underlying the Fifth Amendment right to be free from compulsion of self-incriminating statements.

The Fifth Amendment protects an individual from government coercion in a criminal prosecution. In most instances, the government may not compel an individual to divulge information that might tend to incriminate him. The "required records" exception of the Fifth Amendment was created in part to allow the IRS to require individuals to divulge information that might otherwise be protected by the privilege against self-incrimination. Failure to provide information sought by the IRS is a felony punishable by statute (26 U.S.C. § 7602). Alternatively, the government may issue a summons to the taxpayer or to third parties that will yield information to the IRS. In either case, the information is effectively obtained by IRS through compulsion. The use of that information in a non-tax criminal proceeding, therefore, is sharply at odds with the constitutional policy underlying the Fifth Amendment.

In order to promote fair and efficient administration of the revenue laws and collection of taxes, it is essential not to burden the filing of taxpayer returns with Fifth Amendment problems. If a taxpayer believed that the information he or she was providing to IRS might be routinely made available to other law enforcement agencies, he or she might be disposed to be less cooperative with IRS. The taxpayer would be put in the position of having to scrutinize all of the revelations on the return and determine their relevance to any possible criminal investigation. If as a result of this guesswork, the taxpayer determined the possibility of self-incrimination, he would, at that time, claim a Fifth Amendment privilege, for fear of losing it otherwise at a later stage. See Garner v. United States, 424 U.S. 628 (1976). This process would make the tax collecting process so complex and so cumbersome as to render it fundamentally ineffective. The Privacy Commission expressed concern for this result in noting that "widespread use of the information a taxpayer provides to the IRS for purposes wholly unrelated to tax administration cannot help but diminish the taxpayer's disposition to cooperate with the IRS voluntarily. . . . Such a tendency in itself creates a potentially serious threat to the effectiveness of the federal tax system." *Report of the Privacy Protection Study Commission*, p. 540.

These impediments are unjustified. Moreover, they are unnecessary. The number of potentially valid Fifth Amendment claims would be small in comparison with the total number of people filing returns. The more practical solution is to allow the tax return process to go unimpeded by Fifth Amendment considerations--and that is precisely why the "required records" exception to the Fifth Amendment was created, and why it was limited to circumstances such as revenue collection.

These broad questions of constitutional policy concerning the disclosure and dissemination of tax information provide the background against which the specific amendments under discussion today must be viewed. Because the IRS has been accorded special and extraordinary powers, we are fundamentally opposed to *any* dissemination of tax information within the government. If, in some extraordinary case, such dissemination is authorized by statute, we believe it is essential that in order to justify it, the government must meet a high burden of proof. From this perspective, we are not satisfied with § 6103 as currently written, but we strongly oppose any attempt to further dilute its protections of taxpayer privacy.

I will now highlight the specific objections we have to the proposed amendments.

Narrowing of the Definition of Protected Taxpayer Information

The bill collapses the current three-tier classification of IRS information into two categories. This change would substantially diminish the protection afforded the information in IRS records. Under existing law, the government must obtain a court order to gain access both to taxpayer returns and to what is called "return information." The latter category includes any information the IRS collects or obtains from the taxpayer with reference to the return. Such information might include documents substantiating claims for deductions, contributions or related expenditures. Current law protects this information with the court order requirement precisely because it is at least as sensitive as the information on the face of a return.

Under the proposed two-tier classification scheme of S. 732 any taxpayer information or documents which are not taxpayer returns would be available to the government upon receipt of a written request by an attorney for the government. No independent judicial check on these disclosures is required. Moreover, the bill places on the IRS an affirmative duty to disclose any such information to the government which may be pertinent to a federal criminal investigation.

We submit that this change in definitions eliminates much of the protection of 6103. The comment to the proposed change suggests that the bill will enable the Congress to separate those items which deserve a higher degree of privacy and hence a court order for disclosure, from those items that IRS, like any other investigative agency, uncovers in a typical investigation. This is misleading. It is by no means clear that the information on the return is the information deserving of a higher degree of privacy. Indeed, there is good reason to believe that other information compiled and maintained by IRS is of an even more private nature.

The proposed new definition of protected taxpayer information draws a distinction between an individual's tax return and a corporation's tax return, apparently on the assumption that a corporation's return (consisting of more than two owners or shareholders) does not contain sensitive information concerning individuals. Such a premise is unjustifiable. A corporation's tax return can reflect a person's stock holdings, how he or she voted on internal matters and confidential communication between the corporation and an individual

Standards of Proof

S. 732 would substantially lower the standards of proof that a government agency must meet in order to obtain access to taxpayer information.

Prior to the enactment of the Tax Reform Act, the Privacy Commission recommended that when another government agency requests taxpayer information from IRS, the taxpayer be given notice, and an opportunity to contest the disclosure. Disclosure could then be authorized by a court only if it found:

a. probable cause to believe that a violation of civil or criminal law has occurred.

b. probable cause to believe that the tax information requested from the IRS provides probative evidence that the violation of civil or criminal law has occurred; and

c. that no legal impediment to the applicant agency acquiring that information sought directly from the taxpayer exists.

Report of the Privacy Protection Study Commission, pp. 553-4.

The Tax Reform Act clearly fell short of these proposed safeguards. An *ex parte* proceeding requiring a demonstration of reasonable cause is considerably less rigorous than an adversary proceeding demanding probable cause. Further, the third consideration, that no legal impediment exist to direct solicitation from the individual, was overlooked altogether.

The proposal in S. 732 would further undermine taxpayer privacy by eliminating altogether the requirement of a court proceeding, or demonstration of reasonable cause with respect to the disclosure of non-return information. Substituted for these safeguards would be the word of the government attorney that the information sought is material to an ongoing investigation. In short, the proposed legislation eliminates any protection of tax information held by the IRS, other than the tax return itself.

S. 732 also reduces the standard of proof required to justify issuance of an ex parte order for dissemination by the IRS of the actual tax return. We oppose this further erosion of taxpayer privacy protection.

Section 6103 of the Tax Reform Act now requires a showing that there is reasonable cause to believe that:

a. a specific criminal act has been committed;

b. the information sought is probative evidence of a matter related to that criminal act; and

c. the information cannot be obtained elsewhere.

Again, these statutory standards fall short of the Privacy Commission recommendations. However, S. 732 would further reduce the safeguards. Under S. 732, the government need show only that:

a. there is reasonable cause that a specific criminal act has been committed;

b. the information is sought for an investigation concerning such act; and

c. there is reasonable cause to believe that the information sought may be relevant to a matter relating

While the "reasonable cause" language is retained, the bill affects several changes damaging to taxpayer privacy. There is no requirement--only that it "may be relevant"; and there is no requirement that the information be otherwise unobtainable.

These lower standards will open up tax records of innocent taxpayers to a wide variety of new investigative uses. For example, if the Department of Justice were engaged in an ongoing investigation of a suspected criminal enterprise, the proposed standards would allow the Department to gain access to tax records of any individuals innocently associated in any way with that enterprise. While it may be argued that the focus of the amendment is on drug trafficking and organized crime, it is too easy to forget that similarly loose standards created the enormous record of abuses of IRS disclosures prior to the enactment of the Tax Reform Act.

There is little factual documentation of the need for these changes in the standard of proof in the Tax Reform Act. When asked to supply such information, the General Accounting Office was unable to do so. In fact, in March 1979 the GAO issued a study of the disclosure and summons provisions of the Tax Reform Act, which concluded that "the adverse impact on coordination between IRS and other members of the law enforcement community as a result of the disclosure provisions has not been sufficiently demonstrated to justify revising the law." Report by the Comptroller General, Disclosure and Summons Provisions of 1976 Tax Reform Act--Privacy Gains and Unknown Law Enforcement Effect, March 12, 1979. Not only are the good intentions of the sponsors inadequate to justify legislation of such potentially harmful consequences, but there is no clear evidence that the proposals would achieve their intended goal.

Duty of IRS to Disclose

The bill would make a major change in existing law by requiring IRS to disclose "to the appropriate federal agency" any non-return information which "may constitute evidence of a violation of federal criminal laws." Under current law IRS is not mandated to make such disclosures and the burden is on the investigating agency to initiate a written request or court order procedure. The proposed change makes IRS an active participant in non-tax investigations and thereby substantially undermines the integrity of its tax information gathering procedures. Moreover, the burden placed on IRS of constantly searching its records to determine if they "*may* contain evidence of crime" is unreasonable, unworkable and wasteful of administrative resources.

Redissemination

S. 732 contains no check on the chain of dissemination of taxpayer information within the government. Indeed, the bill explicitly provides that:

> "An agency head, an I.G., or the A.G. or his designee may further disclose non-return information to such federal personnel or witness as he deems necessary to assist him. . ."

The comment to the bill notes that this provision is almost identical to the grand jury secrecy rules. This comment overlooks the crucial fact that in grand jury proceedings, the government cannot compel self-incriminating testimony, at least without a grant of immunity. Since the fundamental issue here is the use of information that is coerced without a grant of immunity, the analogy the comment draws is inappropriate.

The government must meet an extraordinarily high burden to justify dissemination. Once that burden is met at the outset, the removal of all barriers to further dissemination is not justifiable. We suggest that in effect, walls be placed at every step of the process so that highly sensitive information not be disseminated throughout the government on the judgment of the government attorney.

Dissemination to State Agencies

The bill provides for disclosure of IRS information to state law enforcement officials if the information is relevant to investigation or prosecution of a state felony. This proposal is flatly at odds with a Privacy Commission recommendation that disclosure of tax information to the states be was sufficiently concerned about the potential for abuse that exists in inter-governmental disclosure that it suggested limitations even on tax related disclosure. Commission Report, pp. 546-47. Dissemination of taxpayer information is an extraordinary invasion of the privacy of individuals, justified only in extraordinary circumstances. The provision allowing dissemination to state agencies is not justified by such circumstances. Rather, it treats intergovernmental disclosure as a routine matter of coordinating law enforcement, so as to make it more effective. Tax returns should not be treated as a common resource for criminal investigations at all levels of government.

Disclosure to Foreign Governments

S. 732 also authorizes disclosure of information to foreign governments with whom the United States has mutual assistance treaties. Apart from the objection we noted to disclosure to state officials, which applies with equal or greater force to this provision, such disclosure is problematic for another reason. A nation with whom the United States has a mutual assistance treaty could seek access to taxpayer records for use in a criminal investigation for which the standards of proof are dissimilar from those in the United States. Moreover, what is a crime in a foreign country may not be criminal in the United States. The extraordinary coercive powers of the IRS should not be used to gain information about individuals which would then be used for purposes not only different from those for which the information was obtained, but also unsupported by any legitimate United States interest.

The Assistantce of IRS in Joint Tax and Non-Tax Investigations

The bill contains a new provision which states that:

> "No portion of this section shall be interpreted to preclude or prevent the Internal Revenue Service from assisting the Department of Justice or any other federal agency in joint tax and non-tax investigations of criminal matters which may involve income tax violations, nor shall any portion of this section be interpreted to preclude or prevent the Internal Revenue Service from investigating or gathering relevant information concerning persons engaged in criminal activities which may involve income tax violations."

We find this section to be particularly problematic and confusing. An overbroad interpretation of its provisions could be used to negate all specific requirements of a court order to permit the disclosure or subsequent redissemination of taxpayer information by IRS to other federal agencies. There is no definition provided for what the term "assistance" means with in the context of joint tax and non-tax investigation by IRS and other federal agencies. The IRS is theoretically unbridled to provide a broad range of information without the "limitation" of judicial review.

The comment which accompanied submission of the bill indicates that "this section makes it clear on the face of the Statute that IRS is free to work jointly with other government agencies in combatting crime". This statement, of course, goes to the very heart of the issue embodied within these proposals. As we have shown previously, the IRS is not like other federal investigative agencies and should not be "free" to assist other agencies in carrying out functions, of government, for which it was not designed. Clearly, some further clarification of this provision is needed.

Expediting Procedures

We do support some of the proposed changes that would facilitate the process, provided adequate standards of privacy protection are met. We endorse the imposition of time limits; the extension to magistrates of the authority rule on government applications; and the provision allowing attorneys for the government, rather than heads of agencies, to apply for disclosure. In short, we endorse changes in the Tax Reform Act that will allow a constitutionally sound process, which respects individual rights, to proceed more expeditiously.

Conclusion

The claim that the proposed amendments put the IRS back into the fight against organized crime and drug traffic is a distortion. The IRS does not belong in that fight. Its special powers are not granted to facilitate law enforcement. To the extent that IRS in the past has been used as an investigative resource for other government agencies, its special authority was abused. The Tax Reform Act of 1976 was passed to correct those abuses. The current amendments threaten to undermine the Act by redefining the information that deserves protection, lowering the standard of proof necessary to justify disclosure and opening broader channels of dissemination. These changes carry with them an enormous potential for abuse and should not be adopted.

Senator GRASSLEY. I have one specific question and one general question.

The general question comes from the second paragraph of the summary of your statement, where you refer to the Tax Reform Act of 1976 as being needed because of a widespread pattern of abuse of IRS records by Government agencies.

Would you be taking the position in your testimony today that if the Nunn legislation were passed, or if the administration's bill were passed, that we would be back at that point we were pre-1976, or not necessarily that far back?

Mr. SHATTUCK. It would certainly be an invitation to make many of the kinds of broad uses of tax records for nontax investigative purposes, perhaps in the political arena, which is of course what was the gravest concern underlying the 1976 act.

I am not saying that we are necessarily going to go back to that, but I think if Senator Nunn's bill were to pass, it would be an invitation to those who sought to misuse IRS sensitive records to do so again.

Senator GRASSLEY. Again, from your summary, you are asking us to take a look at the proposition that the Government must meet what you refer to as a high burden of proof. Does your testimony include some suggestions along that line?

Mr. SHATTUCK. Mr. Chairman, we endorse the burden of proof that is now in the law.

Senator GRASSLEY. So you are not really suggesting anything new there?

Mr. SHATTUCK. No, we are not suggesting anything new. We say that the Tax Reform Act burden was itself more than was recommended by the Privacy Protection Study Commission. So it was a compromise right then in 1976, and we don't think that any further compromise should be made now.

I would just like to reiterate that if Senator Nunn is serious that the same standard should apply for wiretaps as apply to access to tax records, then the appropriate standard is the standard that is in the law right now.

Senator GRASSLEY. You state that bank records and similar documentary material of an individual are confidential. But under current law, can't Federal law enforcement authorities obtain this information?

Mr. **Shattuck**. Yes, but not from IRS. They can generally obtain it by subpenaing it from the records of a person's bank, or using an administrative summons procedure. There is, of course, a law on the books to authorize that, the Right to Financial Privacy Act. So they can obtain it, but they can't obtain it through the IRS back channels that this bill would authorize.

Senator **Grassley**. I have no further questions. Thank you for your testimony.

Mr. **Shattuck**. Thank you very much.

Senator **Grassley**. Thank you for your organization's interest in this legislation.

The hearing is concluded.

[Whereupon, at 12:45 p.m., the subcommittee adjourned, subject to call of the Chair.]

[By direction of the chairman the following communications were made a part of the hearing record:]

STATEMENT OF SENATOR LOWELL WEICKER, JR.
BEFORE THE COMMITTEE ON FINANCE
SUBCOMMITREE ON OVERSIGHT OF THE INTERNAL REVENUE SERVICE
HEARINGS ON DISCLOSURE OF IRS INFORMATION
ON MONDAY, NOVEMBER 9, 1981

Mr. Chairman, in 1976, Congress enacted strict safeguards to protect the tax privacy rights of Americans. The 96th Congress twice, in December 1979 and December 1980, rejected efforts to weaken these statutory safeguards. On July 27, a similar effort was successful in the Senate in the form of an amendment to H.R. 4242, the Economic Recovery Tax Act of 1981; this provision was droped in conference with the House. The 97th Congress has thus been presented with new legislation incorporating many of the provisions previously debated and rejected in the last Congress. I therefore would like to voice once again the concerns I raised with my colleagues in opposing this unwise assault on the rights of privacy of taxpayers.

As this subcommittee reexamines the 1976 law, I think it would be appropriate to review the history surrounding this important privacy issue.

The starting point is the Fourth Amendment to our Constitution. This Amendment provides that:

> The right of the people to be secure in their persons, houses, papers, and effects, against unreasonable searches and seizures shall not be violated, and no Warrants shall issue, but upon probable cause, supported by Oath or affirmation, and particularly describing the place to be searched, and the persons or things to be seized.

I am certain that my colleagues are familiar with the Amendment. However, how many of my colleagues are aware of the fact that a principal reason for the adoption of this safeguard was the abuse of privacy rights perpetrated by English monarchs in the name of tax collection?

These abuses were discussed by Mr. Justice Blackmun in G.M. Leasing Corporation v. United States, 429 U.S. 338 (1976); he concluded that:

> "Indeed, one of the primary evils intended to be eliminated by the Fourth Amendment was the massive intrusion on privacy undertaken in the collection of taxes pursuant to general warrants and writs of assistance." 429 U.S. at 355.

James Madison realized the necessity of placing restrictions on the powers given to the Government for the purpose of collecting taxes. In arguing for the adoption of the Bill of Rights to restrain the United States Government, Madison said:

> "The General Government has a right to pass all laws which shall be necessary to collect its revenues; the means for enforcing the collection are within the direction of the Legislature: may not general warrants be considered necessary for this purpose, as well as for some purposes which it was supposed at the framing of their constitutions the State Governments had in view? If there was reason for restraining the State Governments from exercising this power, there is like reason for restraining the Federal Government." 1 Annals of Congress, 438 (1834 ed.).

Thus, our Founding Fathers wrote safeguards into the Constitution because they understood that the protection of the basic liberties of our citizens must be founded on law and not on the assurances of government officials. They realized that there is a tendency among those who govern to justify the use of ignoble means to achieve noble objectives. As Samuel Johnson observed, "Patriotism is the last refuge of a scoundrel."

Unfortunately, subsequent generations forgot the lesson that our Founding Fathers had so painfully learned. Despite attempts to limit disclosure, by 1934 income tax returns and information were deemed to be "public records". Federal law enforcement officials were able to obtain tax information simply by stating that, in their discretion, it was "necessary in the performance of...official duties". The Internal Revenue Service, for all intents and purposes operated a lending library.

In 1976, Congress was confronted by overwhelming evidence of abuses similar to those which prompted our Founding Fathers to adopt the Fourth Amendment. The statutory rules governing the disclosure of tax information were reviewed for the first time in over 40 years and tax privacy safeguards were enacted in the Tax Reform Act of 1976 as a result of four interrelated developments.

First, abuses uncovered during the Watergate investigations, documented use of the IRS as an intelligence body to derive information harmful to enemies of the Nixon Administration and helpful to its friends. These abuses were summarized by the House Judiciary Committee in Article II, subparagraph 2 of the "Articles of Impeachment of President Nixon:"

> He has, acting personally and through his subordinates and agents, endeavored to obtain from the Internal Revenue Service, in violation of the constitutional rights of citizens, confidential information contained in income tax returns for purposes not authorized by law and to cause, in violation of the constitutional rights of citizens, income tax audits or other income tax investigations to be initiated or conducted in a discriminatory manner.

Among the most egregious violations of individuals' rights were those committed by the "special service staff," a semi-secret unit operating within the IRS which was charged with collecting information on so-called "activist organizations and individuals." Because there were no limitations at that time on the dissemination of tax return information, the special service staff traded tax information freely with the Justice Department in an attempt to establish non-tax statute violations by these "enemies". Senator Ervin described the questionable activities of this group:

> The special service staff was tasked with collecting, analyzing and disseminating information on individuals and groups publicly promoting what the IRS considered to be

> "extremist views and philosophies." What began with an initial list of 77 organizations mushroomed to an intelligence file on approximately 3,000 organizations and 8,000 individuals who openly disagreed with Government policies...
>
> Special cooperation with other Government agencies with regard to non-tax statute violations was high on the list of special service staff responsibilities. For example, the Internal Security Division of the Justice Department sought out a special informal working arrangement with the staff whereby it would have access to such information. A listing of 14,000 entities which "posed a threat and probability of tax violations was sent by tbe Internal Security Division to the special service staff...
>
> The special service staff's political intelligence activities went far beyond the Internal Revenue Service's proper function of enforcing the tax laws...

In short, abuses of tax privacy rights in the name of non-tax criminal violations were a prime reason for enactment of the disclosure safeguards contained in the Tax Reform Act.

Second, violations of Americans' constitutional rights were discovered by the Church Committee on "Intelligence Activities and the Rights of Americans." The Committee found that there was nothing to insure the limitaiton of the subsequent use of tax information to the purpose for which it was disclosed, and concluded in its 1976 report that:

> The FBI has had free access to tax information for improper purposes...The FBI used as a weapon against the taxpayer the very information the taxpayer provided pursuant to his legal obligation to assist in tax cases and, in many cases, on the assumption that access to the information would be restricted to those concerned with revenue collection and used only for tax purposes.

Third, disclosures were made that special powers of the IRS were being misused to collect information for purposes well beyond tax administration but related to other law enforcement activities. These led to a series of congressional hearings on the propriety of various uses of tax information. In the 93rd Congress, the Senate Judiciary Committee held hearings and numerous hearings were conducted by the Senate Finance Committee and House Ways and Means Committee in the 94th Congress.

Fourth, recommendations were made by the Privacy Protection Study Commission for more stringent safeguards with respect to disclosures of records made by the IRS. The Commission stated that the taxpayer's disclosures to the IRS...

> cannot be considered voluntary because the threat of criminal penalties for failure to disclose always exists. The fact that tax collection is essential to government justifies an extraordinary intrusion of personal privacy by the IRS, but it is also the reason why extraordinary precautions must be taken against misuse of the information the Service collects from and about taxpayers.

The Privacy Commission concluded that:

> Federal law enforcement officials should not have easier access to information about a taxpayer when it is maintained by the IRS than they would have if the same information were maintained by the taxpayer himself.

Mr. Chairman, I have taken the time to review this history because it is important to remember the events surrounding and consideration given the formulation of the existing standards governing disclosure of tax information. Based upon this substantial record, Congress carefully drafted legislation which balanced the rights of Americans to certain privacy standards with the needs of Government in enforcing the law.

Now, less than five years after the striking of this balance, attempts have been made to tip the scales in favor of law enforcement, at the expense of the taxpayer's privacy right. In December 1979, an unprinted amendment was offered to the windfall profit tax bill which would have removed the safeguard of a court order for disclosure of tax return information. That attempt failed by a 65 to 8 vote. In December 1980, on a rider to a continuing appropriations bill that supporters were rushing through a lameduck session of Congress, language to weaken the tax privacy safeguards was offered and tabled by a vote of 43-34. This end-run was made despite the fact - or perhaps because of it - that the Finance Committee held hearings on legislation to amend the Internal Revenue Code and decided not to report a bill to the full Senate.

Similar legislation was offered by Senator Nunn as an amendment to H.R. 4242, the Economic Recovery Tax Act of 1981. The Nunn amendment was approved by the Senate on July 27, 1981 by a vote of 66-28; however, in conference with the House, the Nunn provision was eliminated.

Mr. Chairman, I am pleased to see that Senator Nunn, in introducing S. 732 has made some changes from his previous proposal. Although for the most part minor in nature, these changes do address some of the concerns I expressed during floor debate in the last Congress and while testifying before the Senate Finance Subcommittee on IRS Oversight and the House Ways and Means Subcommittee on Oversight. I applaud these changes, but clearly they are inadequate and fall far short of maintaining the delicate balance achieved under current law between the taxpayer's privacy rights and law enforcement's information needs.

The law presently requires that a court order be obtained by law enforcement officials before the IRS can turn over a taxpayer's return or any information supplied in support of the return. The Nunn proposal, however, would greatly erode the protection now granted to any business, corporation, partnership or association consisting of three or more persons! Why?

As evidenced by the privacy hearings held by the Small Business Committee, businesses are quite concerned about their privacy rights. Tax return information on small businesses invariably contain personal information about the principal of the firm.

There is no reason to relax the burden on the government when it comes to access to records of small or large corporations. For example, there is no lesser standard for search warrant orders for corporate records than for individual's records. The standard is the same because the public as a whole wants to protect privacy rights by preventing "unreasonable searches and seizures" under the Fourth Amendment. Similarly, the Supreme Court has established that speech does not lose its protection under the First Amendment because it has a corporate rather than an individual origin.

Under Senator Nunn's proposal, the taxpayer's privacy rights would further be eroded by relaxing the standards necessary for the Justice Department to prove in order to obtain an *ex parte* order. This standard, which would only require that there be reasonable cause that information sought "may be relevent" to the commission of a crime, is not even as strong as the evidentiary standard proposed in the bill rejected by the Senate last year which required both "relevance and materiality."

The Nunn proposal also eliminates the requirement that the Justice Department exhaust all other sources before it can turn to the IRS to obtain information. This safeguard, which was suggested by former IRS Commissioner Donald D. Alexander, is similar to the requirement deemed necessary by Congress in 18 U.S.C. § 2518 (1)(C) that investigative procedures be attempted before a court may order a wiretap or other form of electronic surveillance. With the erosion of such essential standards, it is likely that the IRS would simply become another automatic, investigative tool to be used by Federal law enforcement agencies in their investigation of criminal activity - much like the taking of photographs or the conducting of surveillances.

Furthermore, the provisions in S.732 which would require the IRS to disclose under "emergency circumstances to "the appropriate agency information "to the extent necessary" contains insufficient safeguards to ensure that the taxpayer is not stripped of his privacy rights. The broad standards of this provision could give the IRS the unbridled discretion to turn over any information in their files to anyone in the government, and threatens to mark the return of the days of the IRS "lending library." This proposal does not even afford the taxpayer the protections contained in 18 U.S.C. § 2518 (7), which require notification to and approval of a court within 48 hours after a wire or oral communication has been intercepted in an "emergency situation".

The loosely drafted provision in S.732 which would permit disclosure to state law enforcement officials also gives me grave concern. The abuses which I enumerated earlier in my statement were not confined to high level Federal employees. There is ample documentation that state and local officials were responsible for equally appalling abuses.

Finally, I am worried about the provision which would authorize disclosure of information on American citizens to foreign countries. The thought that personal information on Americans can be disclosed to other countries which do not have the guarantees of individual rights which are contained in our Constitution is simply repugnant to the principles upon which our nation was founded.

Mr. Chairman, what is the rationale for this back door encroachment upon the rights of Americans? It is done under the banner - which all good citizens willingly carry - of the fight against organized crime, mobsters and narcotics traffickers. Why? Because one is best able to obfuscate the true issues by arguing in an inflammatory way that a change in the law is the only solution to these evils.

One must look behind the rhetoric to ascertain the reason for this legislation. Is is expediency. It is not that the Justice Department does not have the means of obtaining evidence other than from tax return information in its fight against crime. The Justice Department, as evidenced by the great number of its successful prosecutions, does. But it is far simpler - and more expedient - to go directly to the tax return and related information than to the other sources.

Jerry Litton, the late Congressman from Missouri who coauthored the disclosure protections in 26 U.S.C. § 6103, succintly rebutted the expediency rationale. In testimony before the House Ways and Means Committee in January of 1976 he said that "if we are only looking for expediency, let's wiretap every one thousand homes, open the mail of every one thousand citizens, if we are only looking for expediency." But this country does not look simply for expediency when dealing with the rights of citizens. Our heritage is otherwise.

Two hundred years ago our Founding Fathers authored a Constitution premised on the principle that individuals - as human beings - are more important than the conveniences of society. A greater importance was placed on individual liberties than on government efficiency. That was the philosophy underlying the Bill of Rights.

The existing tax information disclosure provisions reflect the fact that Americans are compelled to surrender the Constitutional rights guaranteed by the Fourth and Fifth Amendments - the right to "be secure in their...papers, and effects, against unreasonable searches and seizures" and the right against self-incrimination. In order to facilitate the effective administration of our tax laws, each American voluntarily surrenders certain rights and assumes the duty of self-investigation, fact-finding and reporting. This baring of private papers and matters is an accommodation by citizens to their government for tax purposes - not for scientific purposes, not for non-tax justice purposes, not for sociological purposes, not for political purposes, not for statistical purposes.

The method in which taxpayers voluntarily comply with our tax laws and, in most cases, fully report their earnings is the envy of most other nations where dishonesty is often the rule rather than the exception. If taxpayers become convinced that confidential data they submit each year is used for other than tax purposes, how long will it be before cheating is commonplace? Widespread cheating would be beyond the capacity of teh IRS to control and our entire system of voluntary self-assessment would collapse.

Mr. Chairman, those who advocate diluting existing tax privacy safeguards claim that the Tax Reform Act of 1976 has led to a flourishing of illegal narcotics trading. They seem to ignore, however, the deficiencies of the agency entrusted with enforcement of the criminal statues - the Justice Department. In its March 1977 report entitled "War on Organized Crime Faltering - Federal Strike Forces Not Getting the Job Done," the GAO concluded that, and I quote:

> The Government still has not developed a strategy to fight organized crime.
>
> There is no agreement on what organized crime is and, consequently, on precisely whom or what the Government is fighting.
>
> The strike forces have no statements of objectives or plans for achieving those objectives.

A subsequent report in October 1979, went on to elaborate that government drug enforcement and supply control efforts were hampered by poor coordination, a failure to use available enforcement tools and poor training. The report also concluded that "the adverse impact on the law enforcement community, as a result of the disclosure provisions (enacted as part of the Tax Reform Act of 1976), had not been sufficiently demonstrated to justify changing the law."

Mr. Chairman, the few years that have transpired since enactment of the Tax Reform Act have not shown that Congress erred in enacting needed tax reform legislation or that the provisions of this law have unfairly or unduly burdened law enforcement efforts. What time and experience have shown is not that the law is burdensome, or wrong, or unfairly restrictive, but that those who have interpreted the law have done so incorrectly. For example, in testimony in the last Congress before the Senate Permanent Subcommittee on Investigations, Peter B. Bensinger, the Administrator of the Drug Enforcement Administration, commented with respect to the authority given IRS under 26 U.S.C. § 6103 (i)(3) to disclose to other law enforcement agencies information it has regarding violations of criminal law. Astonishingly, his testimony revealed that DEA records do not show ever having received such disclosures from IRS. This indicates not a problem with the law, but a probelm with the agency empowered to act pursuant to the law. How can one profess that the provisions of the Tax Reform Act prohibit effective law enforcement when a provision of the act designed to assist law enforcement is not properly put to use?

Mr. Chairman, respect for the Constitution and respect for individual liberties should be the prime concern to each one of us here. The protections that are in the present Act certainly allow the proper enforcement of our tax laws and the maximum collection of taxes, but at the same time, assure that history will not repeat itself in this instance, and that Americans' tax privacy rights will be unabridged.

Mr. Chairman, the new legislation introduced by my respected colleague from Georgia, Senator Nunn, and others, should be carefully considered by my colleagues. I believe any legislation making significant changes in statutory tax privacy safeguards requires careful scrutiny. I caution, however, that this is not a matter for hasty action in the name of more effective law enforcement. My colleagues should clearly understand the Constitutional and legislative history compelling strict safeguards of taxpayer rights of privacy. I believe there is an overwhelming burden on those who seek to balance away these fundamental rights.

Mr. Chairman, I very much appreciate the opportunity to testify at these important hearings. For the further information of the subcommittee, I request that a recent article I wrote, entitled "Ensuring Tax Privacy", which appeared in the September 1981 issue of USA Today, be included in the hearing record.

NATIONAL AFFAIRS

Ensuring TAX PRIVACY

"If taxpayers become convinced that confidential data they submit each year is used for something other than tax purposes, how long will it be before cheating is commonplace?"

by Lowell Weicker, Jr.
U.S. Senator (R.-Conn.)

CHIEF Justice Warren Burger got us talking about it again, and the attempt on the President's life wrenched up the debate's volume by quite a few decibels. Ask any person on any streetcorner in America to name the number-one problem plaguing our society today and he is liable to answer: crime. In small town churches and on big city stoops, the consensus is the same—we have got to put a stop to it.

We certainly need to have our consciousnesses raised about crime. Our law enforcement agencies need to be strengthened and streamlined. However, the last thing we should do is beef up law enforcement at the expense of fundamental civil liberties. That in itself would be a crime.

There is one such bill now before the Congress which suggests we make an end run around the Constitution in the name of law and order. Section 6103 of Title 26 of the U.S. Code presently requires that a court order be obtained by law enforcement officials before the Internal Revenue Service can turn over a taxpayer's return or any information supplied in support of the return. Proposed legislation would grant court protection only to the tax return and information filed with it—nothing else. Therefore, any information produced to substantiate the return—such as correspondence, sources of income, investments, any check ever written by the taxpayer, any bill ever paid, and the reasons for doing so—would be routinely available to the Justice Department, which, in turn, could turn the information over to most anyone it wants.

The new bill further erodes taxpayer privacy rights by relaxing the standards the Justice Department must meet in order to obtain an *ex parte* order from the court. It eliminates the requirement that the Justice Department must exhaust all other sources before it can turn to the IRS for information. This provision in existing law, which was suggested by then-IRS Commissioner Donald D. Alexander, is similar to the requirement deemed necessary by Congress in 18 U.S.C. 2518(1)(C) that investigative procedures be attempted before a court may order a wiretap or other form of electronic surveillance.

Although Congress defeated similar bills in each of the last two years, supporters of the new legislation appear to be counting on renewed anxieties and new political alignments to carry the day. Invoking the name of gangster Al Capone, they argue that an activist role for the IRS is absolutely necessary to combat the "triple menace" of organized crime, narcotics trafficking, and labor racketeering. In his introductory statement, the bill's primary sponsor, Sen. Sam Nunn (D.-Ga.) said he looks forward to the day when IRS will "become again the effective force for justice that is was in the days of bootleggers and rumrunners."

My fears for the future are at least as great as Sen. Nunn's hopes, for I believe that, if this legislation is passed, the IRS will again become the tool for Fourth Amendment abuses and political persecution it was prior to the passage of the Tax Privacy Act of 1976.

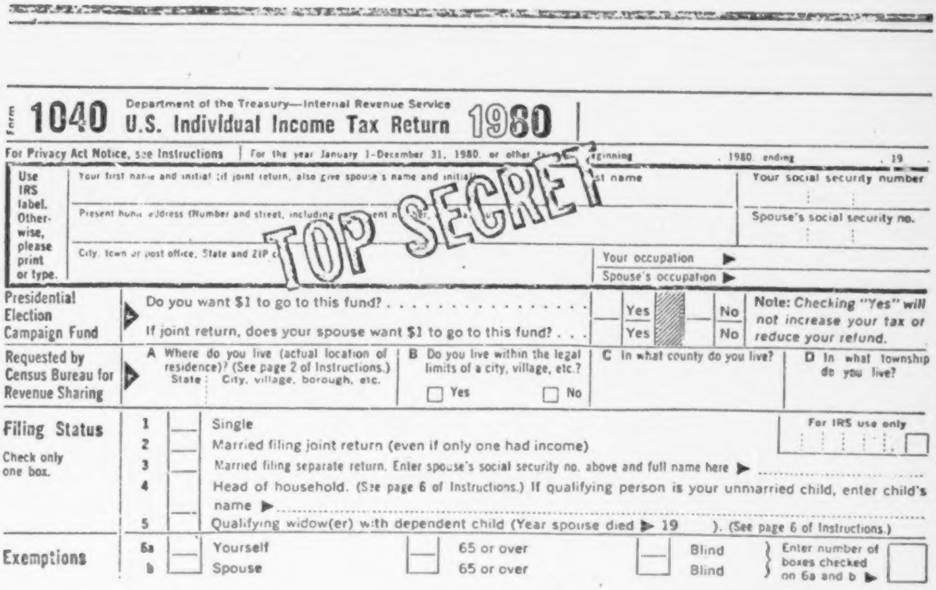
Nobody likes to talk about those days before 1976. The mere mention of them is enough to get yourself accused of wallowing in Watergate. Yet, history has shown that those who refuse to learn from their mistakes are condemned to repeat them.

The fact is that the Watergate investigations documented use of the IRS as an intelligence body to derive information harmful to "enemies" of the Nixon Administration and helpful to its friends. These abuses were summarized by the House Judiciary Committee in Article II, subparagraph 2, of the Articles of Impeachment of Pres. Nixon:

> He has, acting personally and through his subordinates and agents, endeavored to obtain from the IRS, in violation of the constitutional rights of citizens, confidential information contained in income tax returns for purposes not authorized by law, and to cause, in violation of the constitutional rights of citizens, in-

---

Sen. Weicker was the sponsor of the privacy provisions of the Tax Reform Act of 1976.



Form 1040 Department of the Treasury—Internal Revenue Service
U.S. Individual Income Tax Return 1980

TOP SECRET

For Privacy Act Notice, see Instructions | For the year January 1–December 31, 1980, or other ta… …eginning , 1980, ending , 19

Use IRS label. Otherwise, please print or type.
Your first name and initial (if joint return, also give spouse's name and initial … …st name
Present home address (Number and street, including … …ent n…
City, town or post office, State and ZIP c…
Your social security number
Spouse's social security no.
Your occupation ▶
Spouse's occupation ▶

Presidential Election Campaign Fund ▶
Do you want $1 to go to this fund? . . . . Yes No
If joint return, does your spouse want $1 to go to this fund? . . . Yes No
Note: Checking "Yes" will not increase your tax or reduce your refund.

Requested by Census Bureau for Revenue Sharing ▶
A Where do you live (actual location of residence)? (See page 2 of Instructions.) State | City, village, borough, etc.
B Do you live within the legal limits of a city, village, etc.? ☐ Yes ☐ No
C In what county do you live?
D In what township do you live?

Filing Status
Check only one box.
1 ☐ Single
2 ☐ Married filing joint return (even if only one had income)
3 ☐ Married filing separate return. Enter spouse's social security no. above and full name here ▶
4 ☐ Head of household. (See page 6 of Instructions.) If qualifying person is your unmarried child, enter child's name ▶
5 ☐ Qualifying widow(er) with dependent child (Year spouse died ▶ 19). (See page 6 of Instructions.)
For IRS use only

Exemptions
6a ☐ Yourself ☐ 65 or over ☐ Blind
b ☐ Spouse ☐ 65 or over ☐ Blind
Enter number of boxes checked on 6a and b ▶ ☐

come tax audits or other income tax investigations to be initiated or conducted in a discriminatory manner.

A memo made public at a 1974 hearing on warrantless wiretaps and electronic surveillance showed that the IRS set up an "Activists Organizations Committee" to collect information and "find out generally about the funds of these organizations."

In its 1976 report, the Church Committee concluded that "the FBI used as a weapon against the taxpayer the very information the taxpayer provided pursuant to his legal obligation to assist in tax cases and, in many cases, on the assumption that access to the information would be restricted to those concerned with revenue collection and used only for tax purposes."

Why the fuss?

Some may ask, why the fuss about protecting tax returns? If people have nothing to hide, why shouldn't their tax returns be common knowledge? Or, as Sen. Nunn phrases it, "the only people that need fear this legislation are narcotics traffickers and organized crime figures and white collar criminals who are contributing to inflation and who are cheating other taxpayers by not paying their fair share." This type of remark implies that anyone who wants to keep his tax return a secret must be a criminal. If that is the case, it does not speak well for the overwhelming majority of my colleagues who perenially vote against proposals to require Members of Congress to make public their income tax returns. Should their constituents be any more anxious to have their tax returns publicized?

The crux of the problem is that tax returns and their supporting documents contain very telling information. A good sleuth can unearth about as much evidence about an individual from a look at a tax return as you or I could from a thorough search of their home. Rep. Pete Stark (D.-Calif.) spoke to this point before the Senate Finance Committee last summer, while discussing an experiment that appeared on the television news show "60 Minutes":

> We showed that by taking a person who had formerly been a staff member of mine, who agreed to let his credit cards and banking records be looked at by a private investigator from New York, this man was able, just from his records . . . to almost describe his every activity, tell you what doctor he went to, tell you what his health problems might or might not have been . . . how many children he had, whether he drank whiskey, where he was at what time of the year.

This gold mine of facts tax returns contain can certainly give law enforcement personnel a leg up in their investigations. Any FBI agent worth his salt is able to read between the lines of a tax return and discover a dozen leads. The names and addresses of corporations in which individuals hold stock, properties they own, and the identities of those with whom they do business can all help build a case against them. To get at that information without the crutch of a tax return requires footwork. It involves tailing a suspect, cultivating reliable informants, and cooperating with local police—in short, gleaning bits and pieces of the puzzle from dozens of different sources, rather than just one.

Existing law is cognizant of the premium Federal investigations place on tax return information. That is why it gives them the option of obtaining a court order to look at a return. However, the Department of Justice has made diminishing use of this provision since the law's passage. Investigators say that the standards that must be satisfied to obtain a court order are impossibly high. They claim to be trapped in a Catch 22; in order to get at the information on the tax return, they say they must show the court that they already have that information.

However, the standard they are asked to meet is less stringent than that with which law enforcement officers must comply every day. It simply requires that a specific criminal act has been committed and that the tax return sought is probative evidence related to that criminal act. In addition, it must be shown that the information sought can not be reasonably obtained elsewhere.

Suppose someone is suspected of narcotics smuggling. All that must be done under the law as it now stands is to show that a crime has been committed and to put together the beginnings of a case against that person by documenting the very acts that have aroused suspicions. It could be shown that the person associates with people whom reliable informants have identified as equally involved in the drug trade, that he leads the life of a high roller, chauffered from a private jet to his many mansions, without any apparent means of income. An argument can then be made that the individual's tax return is probative evidence of criminal activity, presumably because he would indicate that income and its source on the return. A look at the individual's return in order to clear up the matter of income would be justified, since other investigative means have already been tried without success.

Admittedly, some cases may be more complex, but no one ever said crime fighting was a cinch. The Department of Justice trains its litigators in the P's and Q's of trial tactics. Why shouldn't it teach its attorneys how to apply for *ex parte* rulings under the Tax Privacy Act?

The Justice Department's gripes do not end there. Its attorney-investigators say that, even after a court order is granted, the IRS has taken up to 13 months to comply. I suggest that this is the fault of the IRS and not the fault of the law, but the Justice Department argues that the law's civil and criminal penalties for unauthorized disclosure of tax information have had such a chilling effect upon the IRS that it is now playing it safe by handing over little or no information at all.

The Justice Department's frustration on this point is understandable, but can't this state of affairs be resolved administratively, without emasculating the law? Everyone agrees that routine law enforcement would be made easier by the tax privacy law's abolishment, but where would that leave the Fourth and Fifth Amendments? As Jerry Litton, the late Congressman from Missouri and co-author of the protections in 26 U.S.C. 6103, pointed out in testimony before the House Ways and Means Committee, "if we are only looking for expediency, let's wiretap every 1,000 homes, open the mail of every 1,000 citizens, if we are only looking for expediency."

Voluntary compliance

The existing tax information disclosure provisions reflect the fact that Americans are compelled to surrender the constitutional rights guaranteed by the Fourth and Fifth Amendments—the right to "be secure in their papers and effects against unreasonable searches and seizures" and the right against self-incrimination. Each American voluntarily assumes the duty of self-investigation, fact-finding, and reporting. This baring of private papers and matters is an accommodation by citizens for their government for tax purposes—not for sociological purposes, not for political purposes, not for statistical purposes.

Most Americans are familiar with the privacy protections in the Bill of Rights, but how many are aware that a principal reason for the adoption of these safeguards was the abuse of privacy rights perpetrated by English monarchs in the name of tax collection?

The abuses that led to the Fourth Amendment were discussed by Supreme Court Justice Harry A. Blackmun in *G.M. Leasing Corporation v. United States* in 1975. He concluded that "indeed, one of the primary evils intended to be eliminated by the Fourth Amendment was the massive intrusion on privacy undertaken in the collection of taxes pursuant to general warrants and writs of assistance."

James Madison understood the necessity for placing restrictions on the tax-collecting powers of the government. Arguing for the adoption of the Bill of Rights, he said:

> The General Govenment has a right to pass all laws which shall be necessary to collect its revenue; the means for enforcing the collection are within the direction of the Legislature: may not general warrants be considered necessary for this purpose, as well as for some purposes which it was supposed at the framing of their constitutions the State Government had in view? If there was reason for restraining the State Governments from exercising this power, there is like reason for restraining the Federal Government. [1 Annals of Congress, 438 (1834 edition)]

The way in which American taxpayers voluntarily comply with our tax laws and, in most cases, fully report their earnings is the envy of most other nations. Elsewhere, dishonesty is often the rule, rather than exception. If taxpayers become convinced that confidential data they submit each year is used for something other than tax purposes, how long will it be before cheating is commonplace? Widespread cheating would tax the resources of the IRS and our entire system of voluntary self-assessment would collapse.

Sen. Nunn notes that statistics compiled by both the IRS and the General Accounting Office indicate that voluntary compliance with the tax laws had diminished since the passage of the tax privacy provisions in 1976, but certainly he can not be trying to link the two. He knows as well as I that compliance has gone down because we have legislated so many loopholes for the big businesses and the wealthiest of individuals. Frustrated by what he sees, the average taxpayer is simply trying to get in on the act and look for a few loopholes himself.

Contorted reasoning is commonplace among those who would wipe away the protections of the Tax Privacy Act. They consider the law the perfect scapegoat for any of a number of society's problems. They perceive a need for better coordination between Federal law enforcement and the grassroots variety. They are right—that need does not exist—but distributing confidential tax information like candy to state and local law enforcement officials will not forge that working partnership; it will simply open the way for abuse at lower levels. Similarly, they have identified a need for more concerted efforts to combat crime that crosses borders and oceans, linking Turkish poppy fields to Swiss bank accounts. They are right about the need for that, too, but to share personal tax information on Americans with other countries which may not have the guarantees of individual rights that are contained in our Constitution is simply not compatible with the principles that inspired the Constitution.

They are concerned about our security as a nation, as well they should be, but to require the IRS to disclose to the appropriate agency any information under "exigent circumstances" is to strip the taxpayer of his privacy rights in the name of national security. The vague standards for this provision would give the IRS the unbridled discretion to turn over any information in their files to anyone in government. This power improperly used would mark the return of the days of the lending library which IRS formerly operated.

As Samuel Johnson so aptly observed, "patriotism is the last refuge of the scoundrel." I do not mean to so label all of those who support this legislation. Many of them are motivated by a desire to combat crime. Then let them vote against, not for, this legislation, for it can only lead to lawlessness in the long run.

We can not allow crime in the streets—or the executive suites—to confuse the issue. We must continue to combat that kind of crime by strengthening the investigative abilities of the Drug Enforcement Agency and the FBI. We must train local law enforcement officials in the most up-to-date methods and see that they have the technology they need. However, the issue raised by this legislation has to do with a different kind of crime, which has much in common with the institutionalized crime of the police state. It is the crime this government and its officials commit whenever the constitutional rights of our citizens are violated. Individuals may not die as a result of this kind of crime, but democratic societies do.